CountPlus
Quality Partnerships, Leading Advice

CONVERGING LINES

Why true professionals will emerge victorious in a new advice paradigm

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EXECUTIVE SUMMARY 1

The coming years may be the most tumultuous in the history of the Australian financial services sector. This paper, based on the research of CoreData, argues that one of the core predictors of future success in the financial advice arena is the rate by which professional practitioners – accountants and financial advisers – can merge within a rapidly forming, entirely new space.

A space that is defined by a convergence of true professionalism, aligned around the pursuit of robust, transparent business and remuneration models, and which place the client firmly at its centre.

Further, a space defined not just by a predominant culture of quality and ethical standards in the pursuit of the best interest of the client, but which is also strongly aligned with licensed entities and professional networks that derive 'purposeful' economic benefit from their innate systematic synergies.

In other words, the natural home for this new advice paradigm to flourish is within the licensee that is purpose-designed to prioritise and sustain quality advice. Such organisations would already have separated product from advice, would derive a commercial lifeblood from maintaining the required high standards through investment in operationalising the best technological, business and regulatory processes, and who encourage strong values and standards to effectively shun poor behaviours and to reject the old sales-based product models.

Between now and 2024, the financial planning industry faces several critical challenges. Fault lines have already emerged within underlying business models of certain financial advice businesses – notably those residing within larger, vertically integrated financial institutions.

Some may withstand additional future shocks, while others are likely to succumb to these new pressures, and simply disappear.

Looming challenges include a potent mix of community, economic and regulatory pressures.

These three provide a 'perfect storm' scenario, that, together with the uncertainty of federal politics in an election year, creates an environment for rapid change.

The impact of the Hayne Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry is but one catalyst for change. Others include higher education and professional standards for financial advisers, heightened regulation, consumer expectations of improved transparency and a realignment of commercial interests as financial institutions continue to sell off their wealth management businesses.

These events will combine to radically reshape the financial planning industry in Australia. As the advice market transforms under these influences, new business models will emerge to enable the delivery of financial advice that meets clients' best interests and is free from conflicts of interest.

The Hayne Royal Commission has heard repeated examples where financial incentives within vertically integrated banks and firms led to poor outcomes for clients. In the aftermath, more stringent regulation of financial advisers and the advice sector is expected.

The CountPlus Market Intelligence Report has found that the advice industry is transitioning to better align the interests of consumers with those of service providers.

Converging lines of professionalism

Market trends will inevitably force greater convergence between financial advice and accounting practices. Increased convergence in accounting and advice will incorporate clients' best interests and meet the higher ethical and professional standards being set by the Financial Adviser Standards and Ethics Authority (FASEA).

The removal of conflicted remuneration structures will be essential to restoring public trust in the industry.

We are likely to see financial advisers adopt modes of behaviour and conduct more in-line with established norms in the accounting profession. Moreover, accounting firms that provide financial advice will likely flourish as consumers increasingly seek out independent, highly educated advisers who are free from conflicts of interest. As some financial advisers leave the industry, being unable to the meet new professional and educational standards, the deficit will be filled by professional accountants, in whom the public holds greater confidence.

The data is clear: The question is how likely is the service provider to act in your best interest? This is behaviour (acting in a client's best interest before the providers best interest) is the most powerful driver of trust. For accountants the score is 82.3% of mass affluent Australians agree, for advisers the score (post Royal Commission) 41.2%.

The findings in this White Paper are supported by research prepared for CountPlus by CoreData in the *CountPlus Market Intelligence Report* which concludes that the combined effect of regulatory changes and consumer demands for better services and transparency will be to push financial planning ever-closer to its desired status as a profession, converging with the accounting profession.

1 The changing landscape plants seeds for convergence

New educational, professional and ethical standards are the latest changes in a series of regulatory reforms that began in 2012 with the Future of Financial Advice (FoFA) regulations and continued with the requirement for advisers to register with the Tax Practitioners Board as tax (financial) advisers.

As the advice market transforms in Australia, new business models will emerge to enable the delivery of advice that is free from conflicts of interest and has the client's best interests at its centre. This convergence is also being supercharged by enabling technology that is accessible by both financial advice and accounting firms.

The *CountPlus Market Intelligence Report* has found that the advice industry is transitioning to better align the interests of consumers with those of service providers. Not all advice businesses will thrive in this changing landscape, but those that do will have the structure and the right ownership backing to articulate and execute clear business plans, and be committed to providing professional, consumer-centric and non-conflicted advice businesses.

As financial advice evolves into a profession, and as advisers evolve towards becoming professionals themselves, greater convergence will occur with other recognised professions, including accounting professionals.

In the future, for every $100 a firm brings in, $60 of that will be from accounting and the balance from financial planning and self-managed superannuation fund (SMSF) services.

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The businesses that emerge from the changing landscape will be better placed than ever before to thrive in a new world of professionalism underpinned by higher educational, professional and ethical standards and stricter regulation.

Migration underway

A push has already begun for quality financial advisers to migrate away from the major institutions and to smaller independent businesses, including accounting firms. The businesses that emerge from the changing landscape will be better placed than ever before to thrive in a new world of professionalism underpinned by higher educational, professional and ethical standards and stricter regulation.

As a result of this transformation, the market dominance of vertically integrated financial firms will, in all likelihood, diminish. Most advisers in Australia are currently authorised by the large financial institutions, that is, three of the big four banks: the Commonwealth Bank of Australia, the National Australia Bank and Westpac, plus AMP and IOOF. ANZ's sale of its wealth business to IOOF has seen a significant number of advisers shift organisations, dropping ANZ outside the ten largest licensees ranked by number of advisers.

As it stands now, the biggest four institutions have almost 3,950 advisers, according to the CoreData report. AMP alone has 2,564 advisers, and following the acquisition of ANZ's aligned licensee businesses, IOOF has emerged as the second-largest advice business in the country, with 1,728 representatives, in 14 separate licensee entities

Over time, these numbers could diminish as independent converged accounting and advice firms become more active players in the financial advice industry and as the number of independent financial advisers grows in line with a more transparent and heavily regulated Australian financial planning industry.

NON-CONFLICTED MODELS WILL THRIVE

We may see the rise of firms charging hourly rates for financial advice, in a similar way that accountants already charge.

Amid upheaval in the financial advice sector, financial planners are facing the challenging task of having to meet higher professional, educational and ethical standards while navigating their businesses through the various storm fronts.

For some advisers, the path ahead is significantly more onerous and challenging than for others. Not everyone will survive the journey. For some advisers and advice businesses, the challenges will be insurmountable. Those who disappear are likely to be replaced by accountants who are seen as independent, transparent and already widely trusted professionals.

Furthermore, as the drive for fee transparency increases, business models will shift. We are likely to see financial advice increasingly provided on a fee-for-service basis that removes the conflicts of interests associated with product sales entwined with advice that vertically integrated firms offer.

The Hayne Royal Commission has cast a light on multiple examples of this, where in-house product was promoted. Moreover, ASIC and the Hayne Royal Commission have found that many advice clients were charged for ongoing advice they did not receive, that is, fees for no service at all.

A fees-for-service business model will eliminate the risk of this happening in the future. The fee-for-service advice model uncouples advice from the 'product'. It does not depend on which fund manager or platform a consumer chooses. Clients are not penalised because they have more assets to invest. Clients are simply charged for the services for which they have received. This is fair and transparent.

We may see the rise of firms charging hourly rates for financial advice, in a similar way that accountants already charge. To date, financial advice fees have typically been based upon how much money a client has invested, or how much money has been invested in superannuation accounts. This is all set to change.

Technology too is enabling this convergence as data is now arriving in real time and changing the accounting business model from record keeping to advice and engagement.

Winners? Those nimble enough to adjust rapidly, create an environment where advisers can focus on advice as their 'product', and still meet the higher professional and educational standards expected of them. Firms that thrive will have the management prowess and willingness to transform into first-class advice businesses that place clients first.

There are other significant market forces encouraging convergence. Stand-alone accounting firms typically are priced favourably when compared with financial planning firms. The revenue stream characteristics of both are starting to look similar as commissions are excised from the financial advice value chain.

Both sectors have an ageing population of owners and succession continues to be a key issue. Financial planners are now also regulated by the Tax Agent Practitioners Board. Accountants must now be licensed through the Australian Securities & Investments Commission to offer financial advice. The cross-over between the two professionals is gaining momentum and likely to continue long into the future.

6 PROFESSIONALISING THE SECTOR TO RESTORE TRUST

A fee-for-service model is likely to promote greater trust in the industry as it is more transparent, and this model uncouples the advice fee from products. This is crucial to restoring trust.

A clear message emerging from the Hayne Royal Commission is that the vertically-integrated business model of the past which supported the cross-subsidisation of advice from product and platform resulted in conflicts of interest that are no longer acceptable. The advice industry is transitioning to achieve a better alignment of the interests of consumers with those of service providers.

The challenges for all participants in the financial services sector are significant and include demonstrating value in a transparent manner, delivering advice and services that are clearly in the best interests of the client. Trust and confidence too must be restored in financial advisers and in the services they provide. For this, they must receive consumer-centric and non-conflicted advice. This advice must be delivered by advisers at a reasonable cost, and profitably, without cross-subsidisation from other product manufacturing or distribution activities.

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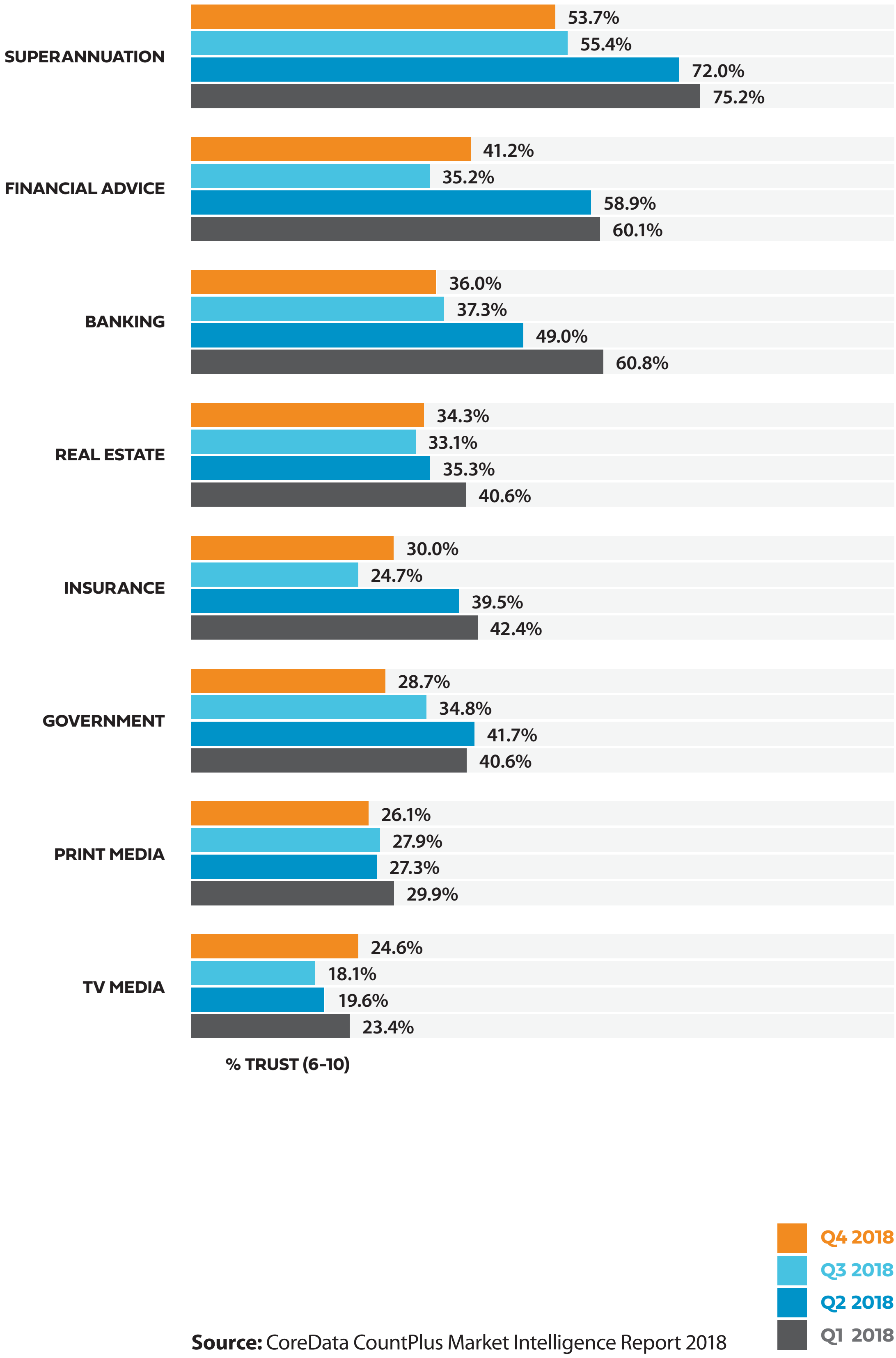
Advice businesses that place the client at the centre of their service offering will thrive, according to the CoreData research. This will include converged accounting and advice firms where advisers will benefit from stricter codes of conduct more in-line with established norms in the accounting profession.

Much must be done to restore the public's confidence in the industry, as it has been damaged by recent scandals. CoreData tracked public trust in financial services businesses through 2018, before the Hayne Royal Commission began its public hearings, and again in October 2018. Over the course of the year, trust in financial services declined across the board, but with some sectors of the industry hit harder than others, as the chart below reveals.

Please rate your trust in the following industries or institutions



Source: CoreData CountPlus Market Intelligence Report 2018

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Advisers must increasingly charge explicit service-based advice fees to their clients to boost transparency and to better represent their value. Such a business model demands that advisers and advice businesses articulate a value proposition and charge clients appropriately for delivering financial advice.

THE VALUE CHAIN – NOW AND IN THE FUTURE

As financial advice evolves into a profession, the value chain is shifting. Large institutions are divesting their wealth management interests, leaving more space for converged advice and accounting firms to become the dominant players in the wealth management chain. Their professional focus on client best interest will put them in an increasingly powerful position.

A product sales-based culture is no longer appropriate for an industry that wants to be regarded as a true profession. It is no longer acceptable to subsidise the cost of providing advice to clients with payments from other links in the value chain. Consumers will not stand for this, nor will regulators.

Advisers must increasingly charge explicit service-based advice fees to their clients to boost transparency and to better represent their value. Such a business model demands that advisers and advice businesses articulate a value proposition and charge clients appropriately for delivering financial advice.

Removing subsidies between links in the value chain will naturally remove many of the conflicts of interest that have plagued the financial planning industry in recent years, underpinning the product sales-based culture. This is a critical step in restoring public trust and confidence in the industry.

The value chain as it is now – represented by the chart below – will evolve where the individual adviser becomes a more important player, as well as converged advice and accounting firms.

Realigning the value chain

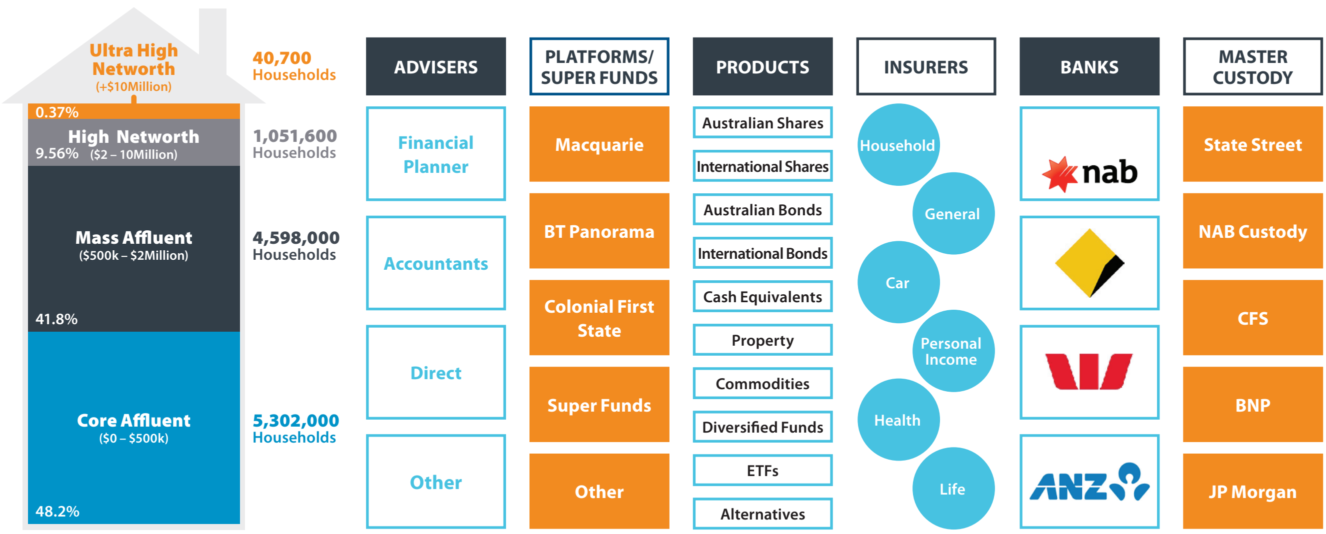

Diagram A: An overview of the key players in the advice value chain

10 CONCLUSION

Greater convergence between financial advice and accounting is likely as accounting firms understand – and are well placed to deliver – a valuable financial advice offering to clients. Moreover, financial advisers are set to adopt stricter codes of conduct more in-line with established norms in the accounting profession.

Advisers and advice businesses unable to meet new regulations and higher professional, educational and ethical standards, face an uncertain future. Those advisers who exit the sector are likely to be replaced by accountants. Convergence between financial planning and accounting firms has gained momentum in the changing financial landscape.

However, there are bright elements for the financial planning industry and not all news is bad.

Australians need financial advice in order to build and protect their wealth. Consumers value advice when they receive it. The CoreData *CountPlus Market Intelligence Report* reveals that despite revelations of unethical and unprofessional conduct unearthed by the Hayne Royal Commission and in the media in recent years, most Australians believe they receive good value for the fees they paid to their financial advisers.

More than two-thirds of people “strongly agree” or “agree” that they receive good value from their financial adviser. Only 8.2 per cent of people “strongly disagree” or “disagree” that they receive good value, as the chart below shows.

To what extent do you agree that you receive good value for the fee you pay your financial adviser?

Source: CoreData CountPlus Market Intelligence Report 2018

This strong vote for the value of financial advice leaves a significant market for converged accounting and advice firms to serve. They will be instrumental in delivering professional services and quality financial advice offerings to Australians, who value those services in building their wealth for themselves, and for generations to come.

As financial advice evolves into a profession, and as advisers evolve towards becoming professionals themselves, greater convergence will occur with other recognised professions, including accounting professionals.