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# Mind the Gap!

The United Kingdom has an advice problem, and it should serve as a warning to Australia.

Despite UK consumers facing financial challenges associated with the pandemic, and many, actively seeking help from financial professionals, the numbers are falling.

A survey conducted in 2021 by Open Money, an online provider of financial advice and money management tools, suggested that the number of people who had paid for advice in the UK was just one in fourteen – down from one in ten the previous year. It noted, however, that of those who had paid for advice, 90% found it helpful and valuable.

In another detailed survey, Royal London, a leading insurer and provider of wealth management products, studied both advisers and customers to better understand the full extent of the UK's growing advice gap.

**Their findings suggest that over 39 million UK adults, or three-quarters of the addressable market, fall into the gap. Many are open and willing to seek and pay for advice but cannot find advisers who would work with them.**

# Neglected customer segments

Advisors felt that the 'floor' – the minimum sum of investable assets needed to bring on a new client, ranges around GBP 48,000, or approximately AUD 87,000. If fact, 20% of the respondents suggested the figure could even be as high as GBP 100,000 (AUD 180,000).

An evaluation into the impact of the retail distribution review and financial advice market by the UK regulator, the Financial Conduct Authority (FCA), determined that customers with investable assets of just GBP 10,000 (AUD 18,000) would benefit from some form of professional financial advice. Still, this segment of consumers continues to be neglected by the industry.

In fact, the Retail Distribution Review (RDR) is generally considered to be the trigger event that led to the creation of this advice gap.

The removal of commission-based products saw many financial advisers, both independent and tied agents from insurance companies and high street banks, exit the industry or downsize and switch to a fee-based model.

I imagine this will sound familiar. Direct parallels can be drawn with the current state of the Australian market following the Haynes Royal Commission.

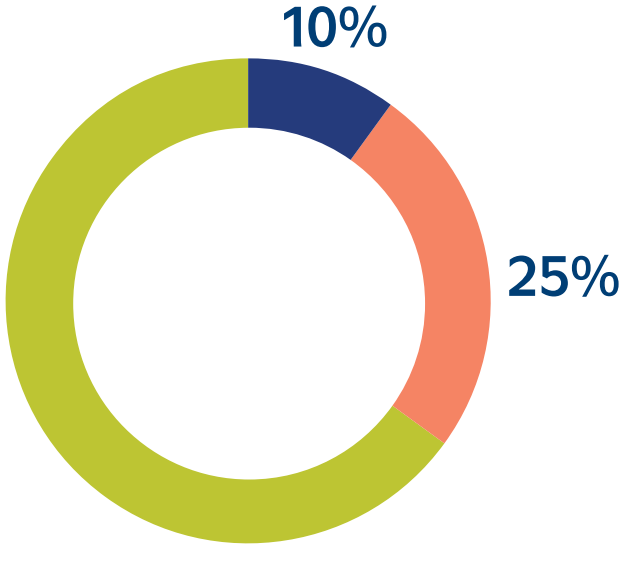
**Skyrocketing prices caused by higher education standards and tighter regulations drove those who remained in the industry towards the wealthier end of the market, increasing competition for a smaller customer segment and leaving many people unadvised.**

# Focus on pension contributions

Obviously, pension planning is just one of many financial areas in which a customer may seek advice, but in considering a looming advice gap, this is the area in which the UK elected to focus.

To combat some of the challenges, The introduced a mandatory low cost pension product, one on which advisers could earn a small commission. Despite some encouraging early adoption, actual contribution rates are considered inadequate by most.

Even if It may seem too some that Australia is able to rely on superannuation to avoid a similar issue, however The Mercer Global Pensions Index, which measures the integrity, adequacy and sustainability of a developed nation's pension systems, has already seen Australia drop to 6th place in 2021, from 4th place in 2020 and 3rd in 2019 and 2018.




Some of this fall can be attributed to changes in policy, but a measurable increase in household debt has led to a reduction in total contributions.

The Open Money survey mentioned previously further highlighted a worrying emerging trend – that almost 1 in 10 younger people, those aged 18-24, are more likely to turn to social media platforms such as TikTok and Instagram for advice than to seek help from a professional adviser.

While I trust Instagram to help me locate the best Acai bowl in Bali, the financial 'advice' I have encountered on these platforms thus far is from influencers promoting dubious crypto asset trading strategies, and a 10-minute TikTok video feels somewhat inadequate to deliver a well-rounded personal finance education.

**A 2021 study by Standard Life found that 10% of those aged 55 to 64 felt they would have sufficient income to last only five years, and 25% felt their savings would last for only ten years.**

# Digital is not the silver bullet

So what are some options available that the Australian industry could adopt to avoid following in the UK's footsteps?

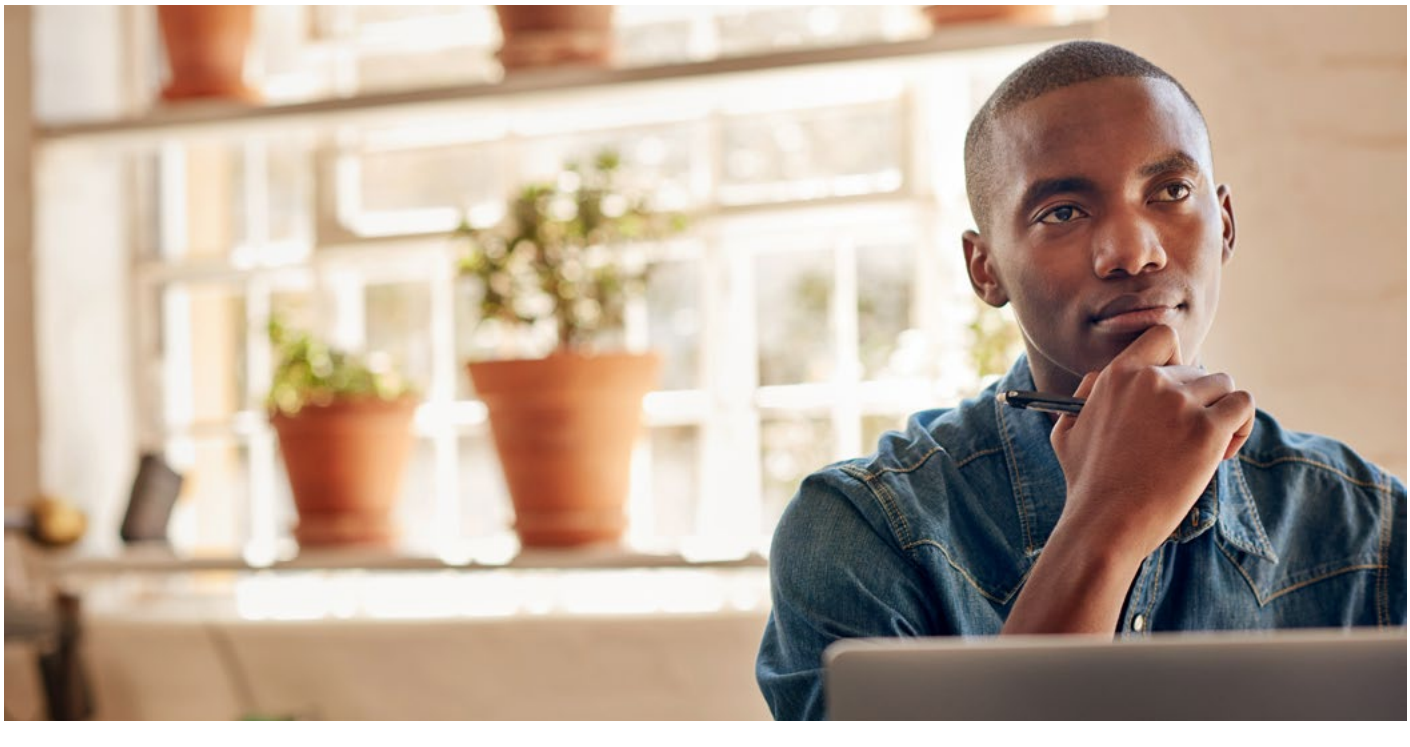
To fully understand the extent of the problem, and to consider suitable solutions, perhaps we must first acknowledge that one of the oft-touted solutions may not really be a solution at all?

Technology-enabled business will help advisory firms to reduce operating costs. The savviest will enable 'digital only' offerings that can serve basic solutions to retail customers at a very low cost, but they may be a far cry from the much-needed, gap-closing silver bullet.

Australia has recently seen a raft of new market entrants with varying flavors of digital advice. The common themes are high levels of technology enablement, fully automated end-to-end execution, digital channel delivery of relatively basic advice and placing the onus upon the client to implement any recommendations that are made.

While some of the solutions will consider and make recommendations in areas such as debt restructuring, cash-based savings and, for some, insurance needs, most are focused on client education only and are built around a Robo advisory type solution.

Obviously, a 'Robo Adviser' is not in fact an advisor at all. I am yet to encounter one that will advise you to buy some life insurance, stay in cash, restructure debt, or drink more water and call your mum more often.



# Limits of Robo advisory

Robo Advisors are simply automated portfolio management systems that enable more efficient, and therefore much cheaper investment management operations.

Some may be linked to goal-based planning tools and many will incorporate risk tolerance questionnaires, thereby creating a perception of 'advice'. For most, the output, regardless of input, is a recommendation to buy an investment portfolio, falling a long way short of the ability to provide true 'holistic' advice.

I'm not so naïve to believe that the same was not true in the old days. When adviser remuneration was linked only (or primarily) to product sales, the outcome of a meeting with an adviser may often have been the same. The perception was, and remains, that only by paying a fee will consumers receive real holistic advice that is not influenced by the need to sell a product.

I should stress that despite having served for many years as a portfolio manager, I am a true convert to the market portfolio. I genuinely believe that for the vast majority of investors, an index replicating strategy comprising low-cost exchange-traded funds (ETFs) will likely provide, if not the best, then at least a satisfactory long-term outcome when compared to higher-cost mutual funds and even some fully discretionary strategies.

Whilst portfolios of this nature can be bought on a mobile device with a small lump sum or a minimal monthly contribution, what these solutions cannot do is control and balance emotions.

A Robo-solution will not tell an investor to hold a falling position. It will not provide a long-term economic outlook. It may not encourage a customer to take advantage of a market dip nor to lock in a gain. On the plus side, it may also not expose clients to unnecessary switching fees or high AMCs, but it will do very little to educate and enforce discipline.

While technology has made it easy for customers to buy financial assets at the push of a button, has it also made it too easy? Has the removal of the gatekeepers also removed the protection?

And this is where the real challenge begins. KPMG now estimates that the cost of providing truly holistic advice in Australia could be as high as AUD 5,335, significantly higher than the Netflix style 'subscription' models being offered by several digital advice providers.

The requirement to produce a full statement of advice for almost every recommendation means that advisers can no longer answer simple questions such as those related to a fund switch without fear of falling foul of the regulator.

# Barriers to financial advice

Clearly, for individuals with only small sums in investible assets, the fees are likely to be very difficult to justify.

Explicit fees, those not linked to commission payments, have always been a challenge for the wealth management and financial advisory industry. Most of the products and services are intangible at the point of sale. The true value of an insurance product may only be recognized should an insurable event occur and the benefit of a well-diversified portfolio may only be known during a market downturn or back looking backwards at the historical performance at some point in the future.

To convince the most inexperienced consumers or those with lower levels of investible assets that any fee level could represent value, they must first be convinced of where the value may lie and then overcome some historical challenges related to trust.

The number of casual workers in Australia in 2019 was almost 25% of the total employed workforce. During the onset of the Covid pandemic, many of these workers, especially those employed in F&B, retail and hospitality, found themselves unemployed and with limited access to benefits. This single event shone a light on how unprepared many younger, lower-income earners are for unexpected events and even very short-term interruptions to their earning ability.

These consumers may not require detailed portfolio recommendations, tax planning, estate planning or other highly specialized services that would require a significant investible sum or a hefty initial fee – but they clearly needed, and may continue to need access to financial education, cash management, information related to debt structuring mortgage advice and advice on life, income and health insurance.

By using investible assets as a selection tool for access to an adviser and Robo or other digital solutions as the only viable alternative, it is easy to see that many Australians will not gain access to advice in many other important areas.

# Closing the gap

So what actions could now be taken to help stave off the growing gap before the problem becomes too big to manage?

There have been several calls from key industry participants that the reintroduction of commissions on some products may now be justified.

Providing that the underlying products are not complex, that a defined sales process is in place and that the products themselves remain competitive from a cost perspective, I would support a move such as this – simply on the assumption that something is generally better than nothing.

Given the perceived victory for some very vocal consumer groups, this seems like a very unlikely outcome.

What is required is a clearer and perhaps less onerous boundary between 'advice' and 'guidance and education'.

Many financial professionals are willing to spend time with less affluent customers, some on an entirely pro bono basis, to help provide guidance and education. Still, due to regulatory concerns, many fear doing so.

My personal recommendation, however, would be for an advice sub-segment limited to the most basic products and services – an 'advice lite' type model.

Product manufacturers would be incentivized to launch low-cost products with capped fees and basic options. Driven by access to the larger volume retail segment, adviser firms can leverage technology to aid in the most cost-efficient distribution methods.

**A clearer definition that provides advisers and other financial professionals the confidence and freedom to offer limited guidance and education without the need to conduct a full review or produce a full, detailed statement of advice would likely be welcomed by all.**

More streamlined and less onerous regulatory requirements could support the provision of limited advice. Reducing the educational and qualification requirements for advisers who service this segment would also benefit the industry.

Many advisers have exited the industry and firms are faced with a difficult choice – spend large sums of money recruiting and retaining experienced and qualified professionals or spending time to recruit, train, coach and develop unqualified or less qualified new industry entrants.

Due to the risk that these new entrants could subsequently move to another organization, the commitment to training is a significant undertaking and a large financial risk. Allowing these new entrants to service less sophisticated clients with more basic needs could partially subsidize this investment as the advisers develop.

There would need to be some significant compromise in the above example – from the regulator, the industry, and the customers themselves. It is unlikely that any outcomes served with a very basic product set would be 'optimal' and the advisers would need some form of protection from future recourse if this was deemed the case.

Financial education needs to be woven into the fabric of Australian education both at school, college and university levels. All consumers should have access to a basic education that highlights the benefits and importance of quality financial planning. If the government can work with employers, education institutions and the financial and technology industry, it is possible that the worst impacts of a looming crisis could still be averted.

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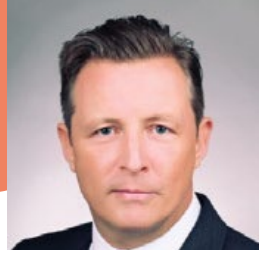

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