Of Financial Advice and Advisers

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Unlike most other expert-service markets, relatively few people make use of financial advisory services, even though constructing lifetime investment plans can be very difficult. One reason may be that most people, for most of their lives, have little or no need for professional investment advice. Faced with mortgage or rent payments and other fixed costs, discretionary savings are limited and saving primarily occurs via superannuation systems which implicitly provide any necessary investment advice via a limited number of approved investment schemes.

But at middle-age and beyond detailed financial advice can be needed, as retirement income shortfalls become apparent, or as discretionary savings (including access to superannuation) become available. Yet relatively few households actively seek, or act upon, professional investment advice. This appears to be an act of commission rather than omission – financial advisers and planners consistently rank low in surveys of most trusted professions.

Such mistrust may be well-founded. As well as recent high-profile disasters (Storm in Australia, Blue Chip in New Zealand) there is no significant evidence that investment advisers add value, and may well destroy it.

Why? First, educational requirements for financial advisers are particularly light, especially when compared with other professions. An undergraduate degree in finance or economics should be the minimum qualification required of aspiring financial advisers .

Second, much financial advice activity focuses on the optimisation of tax and benefit positions, and hence biases education and training towards ensuring up to date knowledge of these areas, at the expense of more fundamental aspects of financial education necessary for the provision of good investment advice. Ideally governments should aim to reduce the complexity of tax and welfare benefit arrangements and thus the need for such advice. Correspondingly, educational programmes should place less emphasis on knowledge of the tax and benefits system, and more on investment theory and fundamentals.

Remuneration arrangements are also an issue. Because personal gains (tax savings etc) from tax and benefits advice can be identified, individuals are generally willing to pay upfront fees for such advice. This is less common for lifetime investment advice where value added can only (at best) be assessed over the longer term. The consequent aversion of clients to upfront fees encourages other less direct forms of remuneration linked to the implementation of the financial advice, e.g., fees based on assets under advice; commissions from providers of recommended financial products; or salary payments to financial advisers from employer-providers of recommended financial products. Such arrangements worsen potential conflicts of interest between the client and the adviser.

Responsibility for the provision of sound financial advice does not lie entirely with advisers – their employers and clients, as well as the government, also have roles to play. For example, the parents of financial advice groups should consider using a range of monitoring and governance mechanisms such as “mystery shopper” techniques to assess quality of advice, as well as specialist internal audit/compliance arrangements focused on ensuring quality of advice and product suitability.

Similarly, government provision and promotion of free website tools that allow clients to check the risk and appropriateness of individual financial plans could also be of great value.

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[i] Information about The Australia New Zealand Shadow Financial Regulatory Committee (ANZSFRC) and a full version of this (and prior) statements can be found at http://www.australiancentre.com.au/acfs-links/anzsfrc/