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The pension advice pickle – How has advice to establish an ABP become so diverse?

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The pension advice pickle – How has advice to establish an Account Based Pension (ABP) become so diverse?

Synopsis

Why is it that the structure and nature of Pension Advice to Members, i.e. what they receive, is determined not by the needs of the member but rather the profession and licensing of the advice provider?

This paper will focus on the Pickle that has become Pension Advice, the result of mis-aligned licensing and SMSF member expectations. The paper endeavours to combine research undertaken by the industry on SMSF Investor profiles, member advice expectations and overlay the various licensing requirements to provide a Pension Advice Matrix.

Recent research found that 58% of accountants indicated they were concerned or very concerned when assisting with SMSF transactions (like pension establishment) if the member had not received advice, "*I am very clear about the fact I only provide factual, tax & SIS compliance advice. But when a client instructs me to implement a strategy, am I required to get a SoA? I don't know!"*

Learning Objectives

1. Understanding when advice should be undertaken v providing facts
2. Determining which SMSF Investors require what advice
3. Understanding one's professional obligations

Current Licensing

From 1 July 2016 amendments were made to the previous accountants' FSRA AFSL licensing exemption *Regulation 7.1.29A,* removing the ability for a recognised accountant to advise on certain financial products and services *inter alia* self-managed super funds (SMSF's) without an AFSL. The previous standard was seen as deficient due to its ambiguity and how it could lead to incomplete advice, the exemption has "been quite a grey area" (Westover, 2014, p. 2).

The repeal of *Regulation 7.1.29A* reflects the Australian Government's policy decision that financial product advice about acquiring or disposing of an interest in an SMSF should be within the scope of the AFS licensing regime, regardless of who provides that advice (ASIC, 2018a)

From this date an accountant must hold a full/limited AFSL or become an AR under another licensee AFSL when making any recommendation relating to financial products and services, including SMSFs (McInnes and Ahmed, 2016). Accountants had until 30 June 2019 to apply for a full or limited license as specified in *Regulation 7.6.01BA* utilizing a streamlined application process, after this date applications must comply with the full obligations of *Section 912(1c) CA.*

What does a Limited License allow accountants to do?

"limited financial service" means the following financial services, *Reg 7.8.12A*:

(a) financial product advice on self-managed superannuation funds;
(b) financial product advice on superannuation products in relation to a person's existing holding in a superannuation product but only to the extent required for:
  (i) making a recommendation that the person establish a self-managed superannuation fund; or
  (ii) providing advice to the person on contributions or pensions under a superannuation product;

Service	Products
Provide financial product advice	Interests in an SMSF Superannuation products, in relation to a client's existing holding, to the extent required for: • making a recommendation to establish an SMSF, or providing advice to a client on contributions or pensions under a superannuation product
Provide class of product advice	Superannuation products, securities, general insurance, life risk insurance and basic deposit products (as defined in the Corporations Act) Simple managed investment schemes (as defined in regulation 1.0.02)
Arrange for a person to deal in a financial product, including applying for, acquiring, varying, issuing or disposing of financial products on behalf of another	Interests in an SMSF

Table 1: Limited financial services authorisations on a limited AFS license

However, according to Chartered Accountants Australia and New Zealand financial advice leader Bronny Speed *"People are finding the risk of running financial advice in an accounting firm, with a limited licence, is getting to a point where the risk is higher to run it than the risk is not to provide the service to clients,"*.

What can a non-licensed adviser (accountant) do?

Accountants/Tax Agent providing services to SMSF's that do not hold and AFS license or are not an Authorised Representative of an AFS license holder can undertake the following exempt services ASIC (2018a).

Type of Service	What can you do	Legislation
Establishing, operating, structuring or valuing an SMSF, including advice and assistance on administrative and operational issues, and the process of winding up or exiting an SMSF	You may provide general factual information on establishing, operating, structuring or valuing an SMSF, as long as you give your client the appropriate warnings. This includes: • general factual information provided for the sole purpose of, and only to the extent reasonably necessary for, ensuring compliance with the superannuation legislation, • general factual information on the process of winding up or exiting an SMSF, But you may not recommend that your client acquires or disposes of an interest in an SMSF.	Regulation 7.1.29(5)
Asset allocation and investment strategy	You may provide a recommendation or statement of opinion on how your client should distribute their available funds among different categories of investments. But you may not advise your client to make particular investments through the SMSF.	Regulation 7.1.33A
Tax advice on SMSFs and other financial products	You may provide general factual information on tax implications of financial products, such as an interest in an SMSF and underlying investments held by the SMSF, as long as you do not receive a benefit as a result of your client acquiring a financial product (or a financial product that falls within the class of products) mentioned in the general factual information and you give your client the appropriate warnings.	Regulation 7.1.29(4)
Tax agent and BAS services	If you are a registered tax agent or BAS agent, you may provide general factual information that is given in the ordinary course of these activities of such an agent and that is reasonably regarded as a necessary part of those activities	Section 766B(5)(c)
Referring clients to an AFS licensee or representative	You may refer clients on to an AFS licensee or representative for financial product advice, as long as you make the appropriate disclosures in the referral.	Regulations 7.6.01(1) (e) - (ea)

Table 2: SMSF Services provided by tax agents/accountants

Accountants/Tax Agents can only rely on this exemption if the general factual information is provided to a trustee, a director of a trustee, an employer sponsor or a person who controls the management of the SMSF. The general factual information must be given to the person in their capacity as a person who controls the assets owned by the trustee of the SMSF, and not in their capacity as a beneficiary of the SMSF.

General factual information provided about establishing, operating, structuring or valuing an SMSF must not amount to an explicit or implied recommendation to establish an SMSF, or to acquire or dispose of an interest in an SMSF (or another superannuation product). However, general factual information supplied to a client about the commencement of a pension may also carry an implicit recommendation that the person acquire an interest in the SMSF.

Will the Accountants exemption Return?

In my opinion this is unlikely.

ASIC through their work in Rep 575 stated, *"we have not seen evidence that TFAs or accountants provide more compliant or better financial advice for consumers than other financial advisers and so do not believe that concessions from the financial advice regime for accountants can be justified on this basis."* (ASIC, 2019)

However, I do believe that the process of providing advice by accountants should be simplified.

ASIC in their submission to the TPB Review stated *"While we do not consider that there is any justification for re-instating the old accountants' exemption (or a modified version of it), we do acknowledge that there are aspects of the accountants' limited AFS licence regime (which was introduced when the exemption was removed) that are difficult to understand and comply with. We would support simplifying the regime through law reform. We would be happy to provide input to any such simplification process"* (ASIC, 2019).

A change to the limited AFS license regime has received further support with the recent re-introduction of JABA calling for a more efficient regulatory framework for advisory services, it is apparent that the industry is at cross-roads of change with all three bodies highlighting the onerous compliance obligations borne by public practitioners (Lian, 2019).

Current collaboration of the JAB with SMSFA and FPA has given further weight to potential changes to the Limited License regime.

Client Expectations

What happens when client expectations do not meet reality?

Research has indicated that 72% of SMSF members previously received advice from a non-licenced tax agent/accountant (The super system review of 2009). Subsequent research has indicated this percentage may have declined to around 50% (Freudenberg and Boccabella, 2016) post the removal of the accountants' exemption.

However, there was and is, an expectation by accounting clients that they can discuss their SMSF's with their accountant, this will be an expectation that needs to be met (Holman, 2014).

There are three outcomes from client expectations: 1. Satisfied (neutral outcome) that is they received what they expected, 2. Dissatisfied (negative outcome) did not receive what they expected and 3. Surpassed (positive) client's expectations were far exceeded.

The 2016 Vanguard/Investment Trends SMSF report found that although SMSF's were open to turning to financial advisers for investment-related advice, the retirement-related advice remained their top "unmet advice need" along with inheritance and estate planning, pension strategies, age pension and longevity risk. Over the three years to 2019 the number of SMSF's with unmet advice needs has risen to a record 315,000 unfortunately a lack of confidence in the expertise of advisers is now the number one barrier for SMSFs seeking advice on their unmet needs (Vanguardinvestments.com.au, 2019).

If approached by your client seeking advice on their 'unmet advice needs' would there be an expectation gap?

Why are clients shunning Licensed Advice?

According to Apricot's research 66% of clients shunned licensed advice because the client was reluctant to pay extra fees, 53% said the cost of the advice was too high and 51% did not trust advisors.

Additional research undertaken in 2015 on Australian SMSF Investors, concluded that many 'self-directed-retirement' members were also unlikely to seek advice due to an overconfidence bias in their technical and investment abilities, this led to lower levels of portfolio diversification and sophistication. Overconfident investors believe they can affect outcomes greater than they can, this causes the investor to overinvest or expose themselves to inappropriate investments and to underestimate the risk being taken in an investment even to an extent where an investor ignores the probability of earning a negative rate of return (Baker, 2014)

Seeking advice appears to result in portfolios that are potentially less risk averse (through holding less cash and fixed income) but more diverse in their asset allocations (Mihaylov, Yawson and Zurbruegg, 2015). This is further evidenced by the level of total overseas assets invested through SMSF's of $13.5bn or 1.9% of net assets (Self-managed super fund quarterly statistical report - September 2019) compared to APRA regulated funds of 24.5% (APRA Quarterly superannuation performance statistics - September 2019)

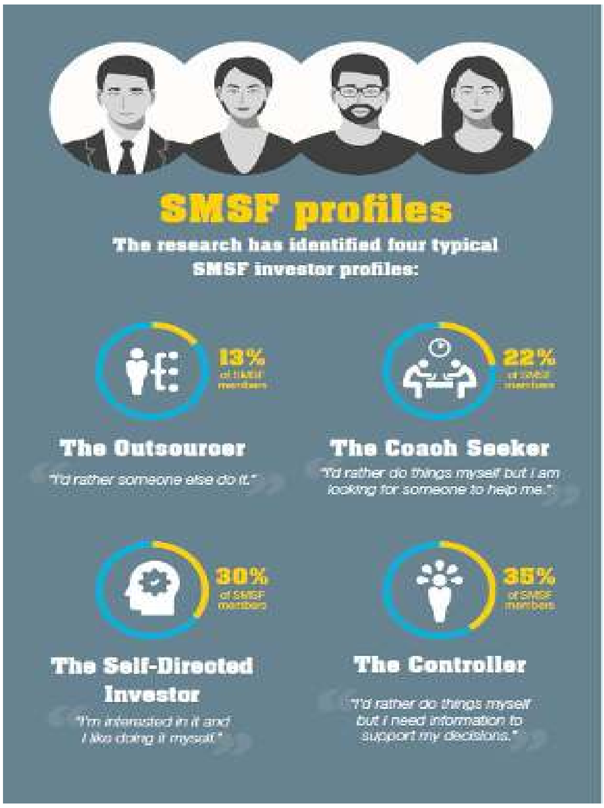
So how can we match unmet advice needs with advisers?

SMSF Investor Profiles

In 2017 the SMSF Association in Conjunction with Commonwealth Bank undertook in-depth research to better understand the dynamics of the SMSF market, with a specific focus on current SMSFs, their advice needs, and their financial decision-making behaviour.

The analysis was based on four distinct profiles which are used to best describe how SMSF investors manage their finances: Outsourcer, Coach Seeker, Controller and Self-Directed Investor. While all of the SMSF investor types share a desire for independence and a need for more knowledge, they often take remarkably different approaches to investment decision-making, due to their very distinctive and diverse advice needs. These four profiles provide a revealing starting point for advisers looking to adapt their offerings to support the needs of different investor types (CommBank and SMSF Association, 2017).

Table 1 below shows the percentage of SMSF Investors across the four profiles.



<u>Diagram 1 – SMSF Investor Profiles</u>

A Better Alternative

Advisers/Accountants need to be well aware of what they can and cannot advise on, each profession has its limitations.

Recent research found that 58% of accountants indicated they were concerned or very concerned when assisting with SMSF transactions (like pension establishment) if the member had not received advice, "*I am very clear about the fact I only provide factual, tax & SIS compliance advice. But when a client instructs me to implement a strategy, am I required to get a SoA? I don't know!"* (Apricot Actuaries, 2019)

Factual information/general advice may be appropriate in undertaking your role as an adviser or an accountant, however how can you be assured that your client has not interpreted, relied on or acted on your statements of fact, as Financial Advice?

A 2018 Research paper of 1,018 respondents concluded that the 'influence' of financial professionals was a stronger motivator than the members desire to establish an SMSF in the first instance (Bird et al., 2018), additional research undertaken in 2019 confirmed that SMSF Trustees are shunning the advice licensing system regardless of whether or not their accountant is qualified under limited licensing (Apricot Actuaries, 2019), the report found that 35% of new establishments were not going on to get advice (The Controller's), while 55% of pension clients also opted not to get advice.

So how can accountants advise their clients & not give 'Financial Advice'?

Change happens when experience conflicts with expectation. The path of change is littered with the debris of those who experience otherwise (Wright, 2010).

In my view the implementation of the 3A process: Awareness, Acknowledgement and Alignment, when providing factual information that:

1. Raises your client's awareness of their knowledge gaps, and
2. An acknowledgment from your client that the information you have provided is factual information only AND that you have identified advice needs AND the client has chosen to obtain advice/or not, and
3. You have aligned yourself with a quality and appropriately qualified adviser network (SMSF Specialist, Financial Planner, Estate Planning Specialist, Lawyer and Auditor)

This can be achieved by asking Epic questions of our clients to help them manage their expectations, identify knowledge gaps and areas of advice need. *"The art of managing client expectations begins with a series of questions"* (Carter, 2006).

What Epic Questions can you ask your Controller & Self-directed client?

- What does your Trust Deed say regarding Pension Establishment?
- What does your Trust Deed say regarding payment of Death Benefits?
- Will your draw-down strategy fund the longest Life Expectancy?
- Will your portfolio income fund your pension liabilities?
- How will you manage sequencing risk?
- Does your investment strategy address diversification as per *Reg 4.09*?
- How will you be managing risk?
- Will you be using Reversionary Pensions or Death Benefit Nominations?
- What's your strategy to reduce Super inheritance tax?
- Have you documented your Estate Planning in contemplation of non-estate assets?
- How have you addressed SMSF Succession?
- Who controls your fund if you lose capacity?

How can advisers deliver better 'Financial Advice'?

Advisers have an obligation under the new FASEA code of Ethics to deliver advice 'diligently' that is 'fair & reasonable and represents value for money'.

Diligently - meaning careful and using a lot of effort in a careful and detailed way. Acting to demonstrate, realise and promote the value of diligence requires that you perform all professional engagements with due care and skill. *It requires you to manage your time and resources to deliver professional services in a timely, efficient and cost-effective way* to each client.

It requires that you exercise due care and skill in the way you, amongst other things:
• *engage* each client;
• *understand* each client;
• *diagnose* each client's needs and issues;
• *scope* or limit the professional services you will provide each client;
It requires that you keep abreast of developments and options for clients (FASEA, 2019).

Fairness - acting to demonstrate, realise and promote the value of fairness requires that you bring *professional objectivity to the task of engaging clients professionally*. It requires you to properly investigate, evaluate and diagnose a client's need for professional services, to self-reflect on the limits of your professional competency and on your capacity to deliver or access the necessary professional services required in the engagement in a manner that benefits your client. It requires your objective assessment of your own services (or your firm's) and whether you can bring value to your client. *It requires understanding your personal biases, and it may require you to act to mitigate the threat of your own, or your client's unconscious biases to your client's decision making*. Being fair requires that you look beyond your own interests and consider how others may judge or perceive your actions. Would your conduct stand public scrutiny by your professional peers and by the community (FASEA, 2019)?

In my opinion advisers need to develop their engagement, understanding, diagnosing, scoping and advice preparation skills which must include a greater use of scoped/limited advice and/or strategy/discussion papers utilising a combination of personal information and facts to present alternatives, advantages, disadvantages and risks but make no specific financial product recommendations in a *diligent, fair and reasonable* manner.

Diagram 2 below details the Pension Advice process incorporating the above.

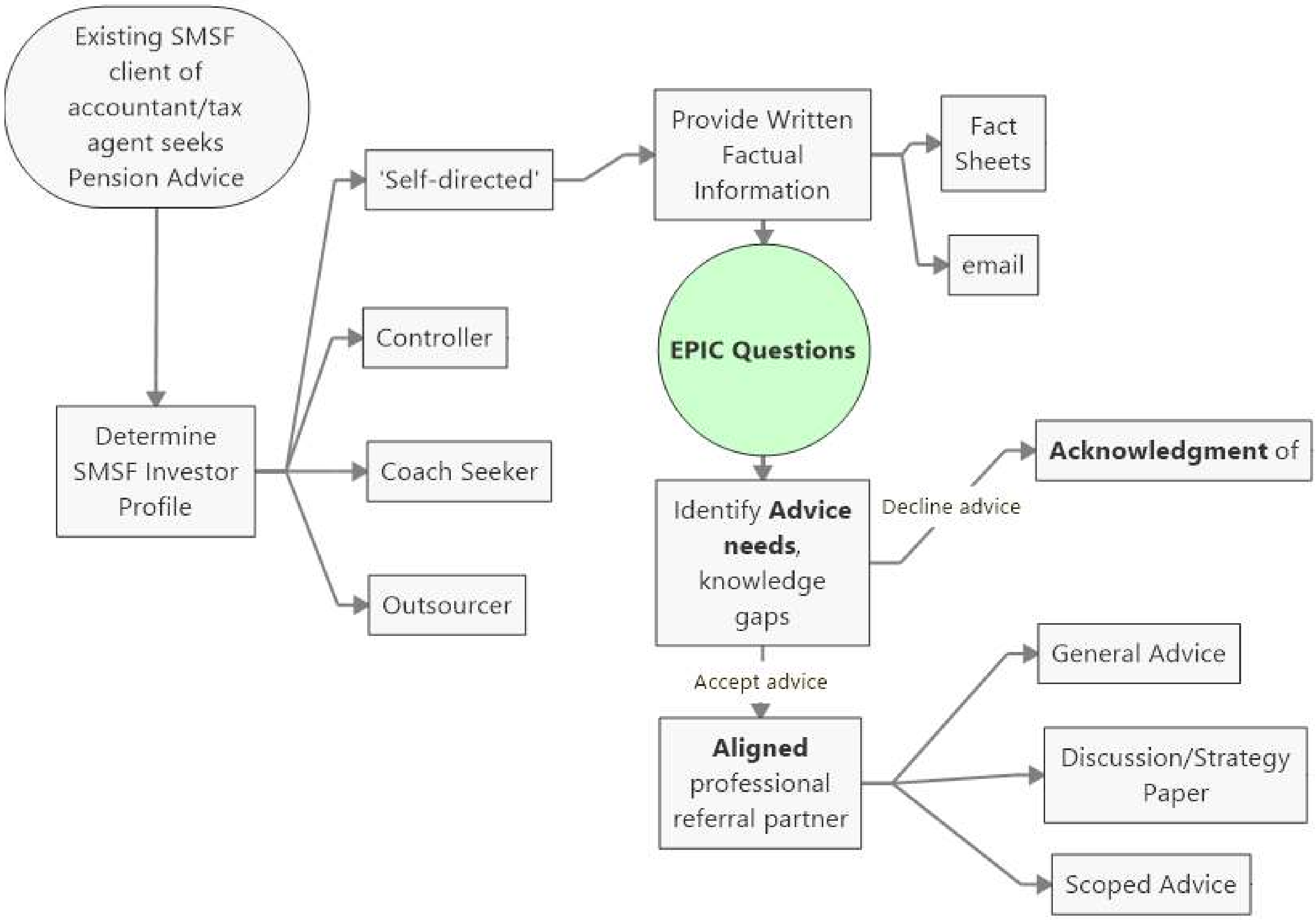


Diagram 2 – Pension Advice Flow chart

Pension Advice Matrix

The Pension Advice Matrix has been designed to incorporate and synthesise SMSF Investor Profiles and the various advice alternatives, although not conclusive, it can provide a ready reckoner for both licensed and unlicensed advisers regarding the establishment of an Account Based Pension.

	The Outsourcer 13%	The Coach Seeker 22%	The Self-directed Investor 30%	The Controller 35%
Main adviser	Financial Planner	Financial Planer	Accountant	Accountant
Factual Information or General Advice	**Inappropriate - they lack confidence, outsource everything, Unlikely to satisfy competence and due care APES110 &/or FASEA and BID**	Somewhat appropriate	**Appropriate**	**Appropriate**
Limited/Scoped Advice	Somewhat appropriate	**Appropriate**	**Appropriate**	**Appropriate**
Strategy Paper	Somewhat appropriate	**Most Appropriate**	**Most Appropriate**	**Most Appropriate**
Full SoA	**Most Appropriate**	**Appropriate**	Somewhat appropriate	Somewhat appropriate

Table 2 – The Pension Advice Matrix

Conclusion

Confusion and limitations of current licensing arrangements have caused a misalignment of client expectations and delivery of professional services that are diligent, fair and reasonable. Advisers need to be well aware of what they can and cannot advise on, and ensure that their statements of fact are not interpreted, relied on or acted on as the provision of financial advice. In the absence of a return of the accountants exemption or a refinement of the limited licensing regime, the process of raising a client's *awareness* of their knowledge gaps via a series of Epic questions, client *acknowledgment* of your statements of fact and an *alignment* with a quality and appropriately qualified adviser network will ensure that your client's advice expectations are exceeded. If you are not wanting to achieve best practice, then according to Dan Butler make sure you are informed of the risks, as what may appear less costly and more profitable now may readily change when the first legal dispute or claim arises.

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