



ASIC

Australian Securities & Investments Commission

REPORT 18

Survey on the quality of financial planning advice

February 2003

What this research report is about

This research report:

- describes the 2003 survey on the quality of advice by financial planners jointly conducted by the Australian Securities and Investments Commission (ASIC) and the Australian Consumers Association (ACA) (**Sections 1 and 2**);
- summarises the findings of the survey (**Section 3**); and
- draws conclusions about the implications of the survey and outlines what further action ASIC will take (**Section 4**).

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Executive summary

The Australian Securities and Investments Commission (ASIC) and the Australian Consumers Association (ACA) conducted a survey of the quality of advice by financial planners. It follows similar surveys in 1995 and 1998.

Methodology

This survey involved 53 consumer volunteers each approaching 3 financial planners and seeking a *comprehensive* financial plan. Each volunteer genuinely wanted financial advice and sought a plan for their own financial circumstances.

The profile of consumer volunteers and financial planners was selected to match the profile of the industry as a whole. The cost of the advice (fee and/or initial commission) ranged from nothing to \$17,000.

The survey received 124 plans that were then assessed by a panel of experts.

The plans were assessed against:

- good practice standards;
- consumer expectations; and
- regulatory obligations (where applicable) (pre-FSRA).

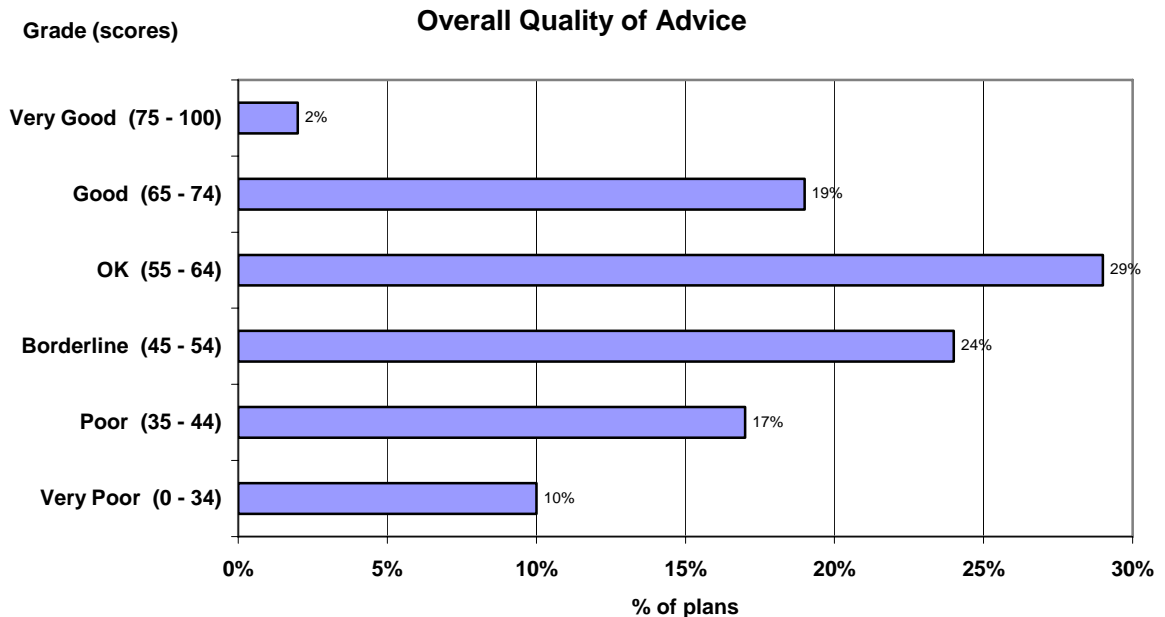
The industry experts judged the written advice against what ought to be in a comprehensive financial plan, based on industry good practice standards and legal requirements. In other words, it measures what consumers received compared to what they asked for (and paid for).

A score was awarded for each of 26 items for a plan. These were added up to give a total score out of 100. The total score was converted to a grade (Very Good, Good, etc).

Results

Grade	Score	No. of plans	Percentage of plans
Very Good	75–100	2	2%
Good	65–74	23	19%
OK	55–64	36	29%
Borderline	45–54	30	24%
Poor	35–44	21	17%
Very Poor	0–34	12	10%
Total		124	100%

The average total score was 54 out of 100.



(Percentages do not equal 100% due to rounding)

Small improvements have been made since their last survey in 1998 in the areas of commission disclosure and assessing client risk profiles. However, the overall quality of advice has not improved significantly when compared to good practice standards.

The following deficiencies were regularly found in plans assessed as part of the study:

- failing to provide an Advisory Services Guide (14% of planners),
- failing to show how the recommended strategy and action was appropriate for the client,
- plans were hard to read and ‘padded’ with reams of generic information,
- planners ignored key client requirements and didn’t explain why,
- higher-fee investments (including wrap accounts and master trusts) were recommended without showing why these were better,
- planners recommended selling existing investments without showing how new investments or investment vehicles would be better.

Aspects dealt with *better* than average included:

- restating clients needs,
- summarising the client's current assets, investments and portfolio position,
- recommending investments with suitable liquidity and flexibility, and
- recommending a strategy and investments that suit the client's risk profile.

Correlation between quality of advice and other factors

The survey looked at the correlation between the quality of advice and other factors. This information may be useful in identifying trends in areas of strengths and weaknesses.

Stockbrokers had a lower average score than the other industry sectors (48 vs 54). A similar pattern was observed in the 1998 survey.

About 70% of the planners had ownership links to product suppliers. This group had a slightly higher average score (56 vs 51). This minor difference may be due to the size of the firm rather than the link, as linked firms tend to be larger.

The survey showed that planners with higher qualifications had slightly higher scores on average. Certified Practising Accountants (CPAs) had an average score of 60 and Certified Financial Planners (CFPs) 58 compared to 53 for those with no extra qualifications.

The overall quality was significantly worse if the planner was only paid by commission. 44% of the "commission only" plans were graded "Poor" or "Very Poor".

There was no significant relationship between the amount under advice and the quality of advice received. However, some people with modest savings had difficulty getting any written financial advice.

62% of plans recommended some kind of wrap account or master trust.

Broad observations

The overall quality of the plans was disappointing.

Only half the planners provided a financial plan that was judged clearly acceptable, when measured against good practice standards and the consumer's request for a comprehensive plan. Another quarter of the planners provided

borderline plans with significant weaknesses. At least 14% did not meet the minimum legal standards.

A common observation by several judges was that clients' interests did not appear to be the sole factor in the plan strategy or product selection. They characterised this practice as "*commission-driven product selling, not impartial advice*".

While there were some excellent individual plans, the overall quality of plans was highly variable, even within the one company. It is apparent that some companies have inadequate quality control systems to consistently produce financial plans that meet good practice standards.

Despite the fact that all volunteers requested a *comprehensive* plan, many planners gave limited advice but did not disclose this clearly (or at all). This suggests a broader problem about both the disclosure and practice of 'limited advice'.

Stockbrokers stood out as having a significantly lower average quality than other industry sectors. This was also observed in the 1998 survey. Given that we only approached stockbrokers that advertised financial planning services, these firms may need to decide whether they want to be in the financial planning market, and if so, how to improve the services they offer. They need to clearly distinguish between financial planning services and investment advice.

Some plans (even simple, low cost plans) were well written and clear. On the other hand, a majority of plans had significant room for improvement in their content and structure. The purpose of advice is to provide reasoned recommendations so consumers can decide whether to take the advice. Judges commented that many plans were unclear, poorly written, swamped with generic material and difficult to follow.

For our survey, the plans were judged on ie pre-Financial Services Reform Act ("FSR") standards. The FSR standards will apply from whenever the principal converts to a new licence under FSR. Principals have until 11 March 2004 to convert.

Under FSR, several good practice standards become legal requirements, especially on the content of the Statement of Advice. A large proportion of financial advice in this survey would not comply with upcoming FSR standards in some respect. Common practices in financial planning will therefore have to change significantly to meet FSR standards.

The Financial Planning Association requires its principal members (representing about 90% of the industry) to comply with the FPA's Rules of Professional Conduct. Many rules mirror the law, but some go beyond legal requirements. The survey revealed significant non-compliance with FPA rules by FPA members. For

example, there appeared to be significant non-disclosure of commissions on insurance products and margin loans.

This raises the issue of how the FPA ensures compliance with its rules and what disciplinary action is taken.

ASIC action

ASIC is taking firm action on the systemic issues revealed in the survey.

ASIC is already engaged in a range of activities across the area of investment advice. These include policy work, industry guidance, licensing, investigations, enforcement actions and consumer education. In the past two years, ASIC has removed 62 financial advisers from the industry and a further 10 have received jail terms.

In light of the survey findings, ASIC has already commenced several additional activities:

- We will be meeting with all firms with “Very Poor” plans and firms where more than one planner failed to provide an Advisory Services Guide.
- We will be requiring some licensees to certify their compliance with relevant legal obligations, including the ‘know your client’ rule and commission disclosure.
- We will be refining our industry information program to ensure firms are aware of the higher advice standards required by the Financial Services Reform Act.

We will also be holding discussions with the Financial Planning Association and leading firms on the best way to improve communication standards in plans.

We envisage conducting another survey some time after the FSRA has been fully implemented.

Section 1 Introduction

1.1 Survey objectives

Consumers rely on investment advisers to provide appropriate, considered advice. Reliance on the quality of advice continues to grow with the increased level of investor participation in the financial market. About 90% of retail managed funds are directed via advisers (excluding employer and industry superannuation). There are estimated to be 16,000 financial planners in the industry. The Financial Planning Association estimates that its 14,500 members service 5 million Australians with a combined investment value of \$630 billion. The industry is therefore very important.

In April 2002, we announced a survey on the quality of advice by financial planners jointly conducted by the Australian Securities and Investments Commission (ASIC) and the Australian Consumers Association (ACA).

The objectives of the survey were:

- 1 to assess the standard of written advice in the financial planning industry against:
 - good practice standards;
 - consumer expectations; and
 - regulatory obligations;
- 2 to report on the experiences of consumers in consulting with a financial planner, particularly on communication issues and the satisfaction of consumers with the service received; and
- 3 to measure any industry developments in terms of quality of advice provided by advisers by comparing results with the 1998 ACA/ASIC survey.

1.2 Acknowledgements

We would like to thank the members of the judging panel for their valuable contribution: see Appendix 1. They each contributed a large amount of time to the survey. Their experience and commitment was a major factor in its success. We would also like to thank the 53 consumer volunteers who participated.

ASIC and ACA acknowledge the co-operation and support of the Financial Planning Association (FPA) in this survey. The FPA provided information about the industry, commented on the methodology and nominated many of the judges.

Section 2 Survey methodology

2.1 “Shadow shopping” process

The aim of the survey was to mirror (as closely as possible) the reality of the financial planning marketplace. The survey involved recruiting 53 consumer volunteers to each approach 3 financial planners and seek a comprehensive financial plan.

Each volunteer genuinely wanted financial advice and sought a plan for their own financial circumstances. Volunteers did not reveal that they were part of a survey, and there were no indications that specific advisers became aware they were being surveyed.

In every respect, the volunteers behaved in the same way as any other consumer seeking financial advice. The only differences were that:

- we chose which planners they visited;
- we paid any fee for advice;
- volunteers were requested to each visit 3 planners; and
- they were specifically instructed to seek a comprehensive financial plan.

Volunteers provided ACA with copies of the advice they received and completed 2 questionnaires about their experience.

2.2 Sample selection — General approach

Overall, consumer volunteers and planners were selected so their profile accurately reflected the profile of the financial planning marketplace. Where our sample differed in some respects, the overall results were adjusted to take the difference into account.

Planning companies were selected first, then volunteers matched against this list to get an appropriate geographic spread.

Although volunteers were sent to 152 financial planners, only 124 plans were received: see section 2.5.

2.3 Selection of financial planners

The overall method was a “random stratified” sample. This is the same method used by research companies to determine voting intentions, brand preferences, etc. Within each industry sector, a number of firms were randomly selected, with the

chance of selection equal to their proportional size in the sector. The method ensured an appropriate number of plans from each industry sector.

Table 1.1 Summary of sample size

	Estimated market share % of planners	Plans received No. (%)
Banks	15%	20 (16%)
Medium–large dealer groups and life companies	74%	85 (69%)
Small planners	10%?	6 (5%)
Stockbrokers ¹	1%	13 (11%)
TOTAL	100%	124 (100%)

Banks

This category included only “in-house” financial planners, not dealer groups that are owned by banks but operate separately.

Medium–large financial planning companies

This group comprised the top 100 financial planning companies (excluding banks and stockbrokers). A Rainmaker survey from 2001 was used to estimate the number of financial planners for each of the top 100 financial planning groups. They ranged in size from the biggest firms (eg AMP with about 1,400 planners Australia wide) to medium-sized firms with 12 or more planners. This group is estimated to represent about 10,000 planners or 74% of the industry.

Our sample was particularly large for Charter Financial Planning (9 plans) and PACT (5 plans). In the case of Charter, volunteers contacting AXA were directed to Charter, an AXA owned company. For PACT, this occurred because we sent volunteers to planners who appeared to be “small planners”, but who turned out to be representatives of PACT.

¹ The stockbroker sector was intentionally over-sampled to get an adequate sample size. However, this would have little overall impact on the overall results.

Small financial planners outside the top 100

The sample for this group was selected proportionally by state. Small financial planners were selected at random from the Yellow Pages “Financial Planner” listing. We had aimed to get a larger sample for this group. However, many of the (apparently) small planners advertising under their own name turned out to be authorised representatives of medium–large dealer groups. The industry is also undergoing a process of consolidation, so some small planners have joined dealer groups since the Rainmaker survey in 2001.

Stockbrokers

Stockbrokers were selected at random from the Yellow Pages. The selection method restricted this sample to firms that promoted themselves as “Financial Planners”.

Hartley Poynton and ABN AMRO Morgans are medium–large financial planning chains (with 214 and 120 planners respectively) but are also active stockbrokers. These 2 firms were categorised as medium–large financial planning chains.

2.4 Selection of volunteers

The volunteer sample was selected to reflect the population of consumers who seek the services of financial planners (based on Roy Morgan research data) in terms of:

- age (25–34, 35–49, 50–64, 65+); and
- value of assets subject to advice (including superannuation).

Table 1.2 Summary of client assets

Client’s investment assets	Plans received
<\$100,000	42%
\$100,000–<\$250,000	20%
\$250,000–<\$500,000	21%
\$500,000 +	18%

Geographic distribution

The sample was distributed across Australia to reflect the distribution of financial planners and clients. The FPA’s statistics on location of practitioner members was

used for this. The distribution is almost identical to the distribution of the population aged 20 and over (the potential client group) according to Australian Bureau of Statistics data.

Table 1.3 Summary of geographic distribution

Region	Distribution of planners & clients	Distribution of plans received
NSW / ACT	32%	27%
Vic	27%	27%
Qld	18%	23%
SA	10%	10%
WA	9%	9%
Tas	3%	4%
TOTAL	100%	100%

Volunteers were also distributed proportionally between capital city and region locations within each state.

The plans received resulted in NSW being slightly under-represented and Queensland being slightly over-represented.

2.5 Obtaining financial advice

Consumer volunteers were given the company's central phone number (if one existed) so they could ask for a referral to a local financial planner. Otherwise, the volunteers were given the phone number for a specific office of the company.

If volunteers were offered a range of payment options (commission, fee or a combination), they were asked to select the option they would choose for themselves. ASIC met the cost of any up-front fee. Generally this up-front fee was in the range of \$400–\$800 dollars. Volunteers with large investment amounts were typically charged higher fees (\$800–\$1,400), but the highest fee was \$6,000. In no instance was a planner excluded because we would not pay the quoted fee.

Volunteers were specifically instructed to seek a *comprehensive financial plan*.

As mentioned in section 2.2, not all volunteers received 3 written plans. In 28 cases where a volunteer approached a planner, they did not succeed in getting a full written plan, for a variety of reasons.

In some cases, the consumer gained the impression that the planner was not interested in them as a client. This may be because the planner was targeting a different market segment. For example, one volunteer of modest means was told by all 3 planners that there was nothing the planner could offer. This was despite the consumer being very anxious to plan for her retirement in 5 years' time and having some spare cashflow.

In other cases, it appeared that the planner was too busy with other clients. Where possible, we nominated a replacement planner. However, in some cases the problem was not apparent until it was too late to arrange a replacement planner.

In some instances, the planner gave verbal advice but would not do a formal plan. Some of the advice appeared valuable and appropriate, such as "*Check you have life insurance, pay off your mortgage as fast as you can and come back to see me when it's paid off*". In other cases, the advice was quite dubious.

In some instances, the planner provided a brief strategy document or educational material, but not a financial plan that could be assessed.

We recognise that not all planners have the skill to address complex needs or prepare a comprehensive financial plan. That should not have been a problem in our survey. If a client's request or needs were beyond the capacity of an individual planner, the licensee should ensure the client was referred to an appropriate planner, or advice was declined.

2.6 Contextual data and client feedback

A wide range of data was collected about the characteristics of the planner, the consumer volunteer and the content of the plan. This enabled extensive analysis of whether the quality of advice was correlated with other factors.

The results are discussed in section 3.3.

2.7 Assessment of advice

Each consumer volunteer completed a fact find (needs analysis) at the beginning of the survey to document their needs and objectives. The assessment panel used this as a broad reality check when assessing the plans.

The plans were divided between 3 panels of judges, so each panel assessed a third of the plans. Each panel was made up of 2 experienced financial planners and a compliance professional.

At the beginning, all 3 panels assessed the same 6 sample plans. These were the focus of a judge's meeting to ensure each judge was interpreting the questions correctly and to ensure consistency in the assessment process. These sample plans did not reveal a wide divergence of views between the judges.

Each of the remaining plans was assessed by 3 panel members. Some black and white technical issues in each plan were assessed by an ASIC research officer.

For each plan, a score was awarded for each of 29 items: see Appendix 3.

Table 1.4 Scoring system for each item

Fail	Poor	Adequate	Good	Excellent	Not applicable
0 1 2	3 4	5 6	7 8	9 10	99

After the panel had assessed a majority of the plans, a further judges' meeting was held to discuss broad trends.

The score for each item was based on assessment against 3 broad criteria:

- 1 the quality desired by an interested, reasonable consumer;
- 2 good practice standards, using the FPA Rules of Professional Conduct where applicable. (The vast majority of planners surveyed are principal member of the FPA and have agreed to abide by the FPA standards); and
- 3 legal requirements, where applicable. (The legislative requirements were pre-March 2002 standards. These standards apply to planners under transitional arrangements until they acquire the new Australian financial services (AFS) licence).

In each category, top scores were awarded if the plan was at the top of the scale on all 3 criteria. "Fail" was awarded if the plan clearly did not meet *any* of the 3 criteria.

In some instances, assessment questions were not applicable to the individual plan. For example, the question about estate planning may be less applicable to a single person with no dependents. In these cases, the question was not counted in the marking and a percentage was calculated out of the remaining questions. No plan was disadvantaged because some assessable items were "not applicable".

A total score for each plan was calculated in this way:

- Each plan was assessed on 29 items (score from 0–10): see Appendix 3. The 3 judges' scores (0–10) for each item were then averaged.
- Each item was worth a certain percentage of the maximum possible score: see Appendix 3. These were added up to give a total score out of 100.
- We analysed whether some judging panels were scoring higher or lower than others. There was a minor difference, so each panel's scores were adjusted up or down so that the average score from each panel was the same.

2.8 Summary of methodology strengths

Overall, the survey's methodology gave it considerable strength:

- This was the third time the survey has been run, giving more opportunities to validate and refine the methodology. The assessment process is a refined version of the methodology designed by Ken Breakspear of the Financial Planners Association in 1995.
- The survey used a large sample size and covered the whole industry;
- The sampling techniques were scientifically based to accurately reflect the reality of the financial planning marketplace;
- The survey used real consumers who were in the market for financial advice, not actors. Therefore the survey captured the diversity and quirks of real life;
- The survey was conducted with the co-operation of the industry association, although individual planners did not know they were being surveyed;
- Planners were largely judged by their peers.
- The survey allowed for clients' perceptions about the strengths and weaknesses of the service they received.

Section 3 Results

3.1 Overall quality of advice

As discussed in section 2.7, the scores for each of the 26 assessable items for each plan were combined into a total score out of 100 for the plan. The average total score was 54 out of 100.

Each plan was then given an overall grade ranging from “Very Poor” to “Very Good” based on its total score.

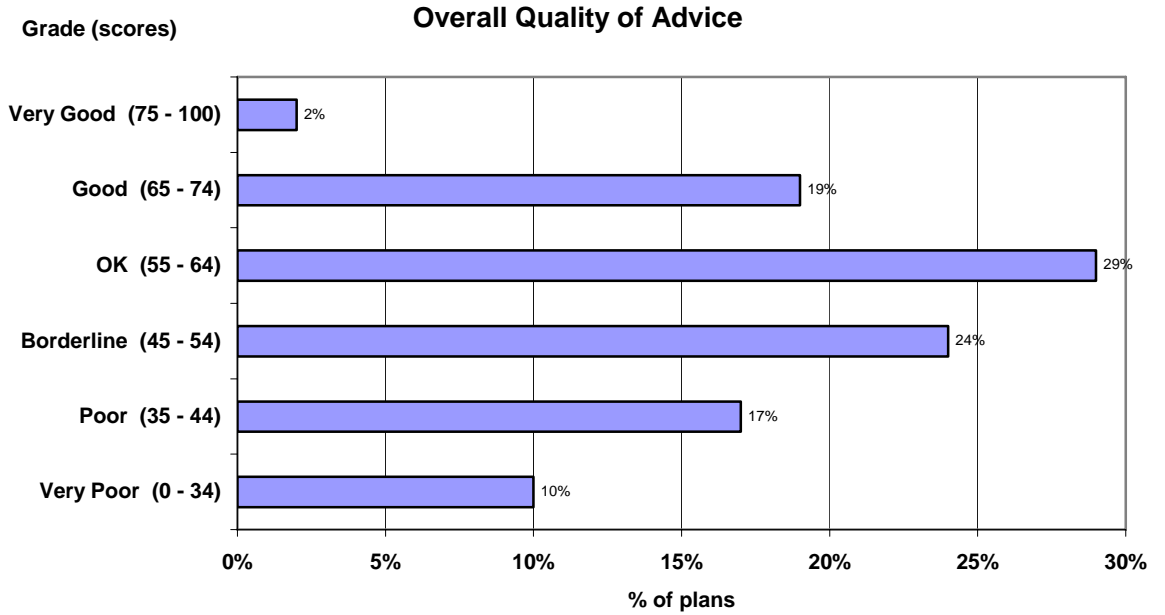
Table 3.1 Breakdown of grades

Grade	Score	No. of plans	Percentage of plans
Very Good	75–100	2	2%
Good	65–74	23	19%
OK	55–64	36	29%
Borderline	45–54	30	24%
Poor	35–44	21	17%
Very Poor	0–34	12	10%
Total		124	100%

(Percentages do not total 100% due to rounding)

Plans were downgraded if they had scored “Fail” for a particularly critical item:

- plans marked “*” were downgraded to “Poor” if they didn’t provide the client with an Advisory Service Guide (Item 1.1); and
- plans marked “#” were downgraded to “Very Poor” if they failed to show the suitability of specific investments in relation to client’s needs and goals (Item 4.1) or to show appropriateness of advice overall (Item 4.5).



(Percentages do not equal 100% due to rounding)

Table 3.2 Survey results

Principal ² (ownership link) ³	Score	Principal ² (ownership link) ³	Score
Very Good		OK (cont)	
IPAC 1 (now AXA)	82	AMP 2	63
Financial Lifestyle Solutions (Zurich)	76	Apogee 3 (National Bank)	63
Good		Westpac 2	63
Macquarie	74	Professional Investment Services 1	62
Mercer	74	Professional Investment Services 2	62
Charter 1 (AXA)	73	Westpac 3	62
Godfrey Pembroke 1	73	Australian Financial Services (Zurich)	61
Charter 2 (AXA)	71	Garvan 2 (National Bank)	61
Small planner 1	71	Garvan 3 (National Bank)	61
Charter 3 (AXA)	70	Inscorp (Tower)	61
Community & Corporate	70 ⁴	Lifespan	61
Godfrey Pembroke 2	70	Lonsdale (Zurich)	61
Lynx 1 (ING)	69	JB Were 1	60
Ord Minnett 1 (J.P Morgan)	69	PACT 1 (St George Bank)	60
Charter 4 (AXA)	68	Securitor 1 (St George Bank)	60
Fiducian	68	Suncorp	60
Ord Minnett 2 (J.P Morgan)	68	AMP 3	59
ABN AMRO Morgans 1	67	Apogee 4 (National Bank)	59
Apogee 1 (National Bank)	67	Charter 6 (AXA)	59
Charter 5 (AXA)	67	Charter 7 (AXA)	59
Hartley Poynton 1 (Westpac)	67	Compound Investments (Count)	59
Apogee 2 (National Bank)	66	Deakin	59
AXA	66	Small planner 2	59
Hillross 1 (AMP)	66	Professional Investment Services 3	58
AMP 1	65	Commonwealth Bank 1	57
Hillross 2 (AMP)	65	Hillross 3 (AMP)	57
IPAC 2 (now AXA)	65	Lynx 2 (ING)	57
OK		Small planner 3	57
ANZ Bank 1	64	ANZ Bank 2	56
Bell Potter 1	64	Financial Wisdom (C'wealth Bank)	56
Garvan 1 (National Bank)	64	Professional Investment Services 4	56
Westpac 1	64	Commonwealth Bank 2	55

² The names of small planning firms are not printed to prevent a disproportionate impact on their business where results are low.

³ Includes part ownership. "now XYZ" means the link was formed after the survey plans were obtained.

⁴ Revised result

Principal (ownership link)	Score
Borderline	
Guardian (<i>Royal & Sun Alliance</i>)	54
Associated Planners (<i>Zurich</i>)	53
Count Wealth Accountants 1	53
Count Wealth Accountants 2	53
Count Wealth Accountants 3	53
Garvan 4 (<i>National Bank</i>)	53
Hartley Poynton 2 (<i>Westpac</i>)	53
Hillross 4 (<i>AMP</i>)	53
PACT 2 (<i>St George Bank</i>)	53
Retireinvest 1 (<i>ING</i>)	53
ABN AMRO Morgans 2	52
Small planner 4	52
Small planner 5	52
Westpac 4	52
Charter 8 (<i>AXA</i>)	51
Professional Investment Services 5	51
WB Financial Management	51
Commonwealth Bank 3	50
Count Wealth Accountants 4	50
PACT 3 (<i>St George Bank</i>)	50
Professional Investment Services 6	50
Intersuisse	48
Westpac 5	48
Wilson HTM 1	48
Godfrey Pembroke 3	47
JB Were 2	47
Commonwealth Bank 4	46
Mawsons 1 (<i>now Tower</i>)	46
PACT 4 (<i>St George Bank</i>)	46
AMP 4	45
Poor	
Commonwealth Bank 5	58 *
Count Wealth Accountants 5	58 *
Commonwealth Bank 6	56 *
Stockford	52 *
Count Wealth Accountants 6	49 *

Principal (ownership link)	Score
Poor (cont)	
Commonwealth Bank 7	46 *
Westpac 6	44
Baker Young	43
Wilson HTM 2	43
Protax 1	42
AMP 5	41 *
Garrisons (<i>Challenger</i>)	41
Small planner 6	41
Westpac 7	41
Professional Investment Services 7	40 *
Fidelity	37
Shadforth	37 *
St George Bank	37 *
Retireinvest 2 (<i>ING</i>)	36
MLC (<i>National Bank</i>)	35
Very Poor	
ANZ Bank 3	48 #
Securitor 2 (<i>St George Bank</i>)	44 #
Charter 9 (<i>AXA</i>)	35 * #
AMP 6	33 *
Bell Potter 2	32 #
PACT 5 (<i>St George Bank</i>)	32 #
JB Were 3	31 #
Protax 2	31 *
Tolhurst Noall	29 *
Mawsons 2 (<i>now Tower</i>)	25 *
Mawsons 3 (<i>now Tower</i>)	24 #
AMP 7	21 *

*Critical error — No ASG provided
(downgraded to “Poor” if score above 45)

Critical error — Failed to show “appropriate advice” and/or “strategy matches clients needs”
(downgraded to “Very Poor” if score above 35)

3.2 Specific aspects of plans

The average score (see Table 3.3) for each of the 26 aspects assessed for each plan indicates how well the aspect was dealt with across the industry.

Items where the average score was *below* 5 out of 10 (the low end of “Adequate”) included:

- description and analysis of tax position;
- analysis of cashflow;
- description and analysis of risk protection (very poor);
- description and analysis of retirement planning;
- description and analysis of estate planning (very poor);
- description of periodic review processes; and
- clear justification of client–product nexus.

Items where the average score was *above* 5 out of 10 included:

- restate clients needs;
- description and analysis of current investment and portfolio position;
- description and analysis of current assets and liabilities;
- suitability of investments in respect of liquidity and flexibility (very good); and
- strategy and investments match client’s risk profile.

For a detailed commentary on each aspect of the plans, see Appendix 3.

A “comprehensive financial plan”

The plans were judged against a standard list of features for a “comprehensive financial plan”. We do not believe there would be a wide range of opinions about what to cover in a comprehensive plan.

However, to test if this could have been a problem in our survey, we examined the impact of ignoring items that might not be essential for some clients, such as:

- cashflow position;
- risk protection and insurance;
- retirement planning; and
- estate planning.

The results with these items removed were virtually identical to the original results. Scores out of 100 changed by between -1 and +3. Only 8 plans changed grade (all downwards).

Table 3.3 Summary of results for each aspect

Item	Average score (out of 10)	% Poor or Fail	% Good or Excellent
1 Advisory Services Guide			
1.1 Guide provided (yes = 10, no = 0)	8.6	15%	85%
1.2 Disclosure of adviser's status	6.4	25%	57%
1.3 Disclosure of relationship to product suppliers	7.1	20%	77%
1.4 Disclosure of adviser remuneration	6.4	16%	59%
1.5 Disclosure of complaint mechanisms	7.8	22%	79%
2 Plan structure			
2.1 Disclosure of limited advice	5.1	35%	19%
2.2 Client's preferences and needs	5.4	25%	29%
2.3 Cashflow position	4.9	35%	22%
2.4 Assets and liabilities	5.7	19%	37%
2.5 Current investments	5.5	19%	33%
2.6 Tax position	4.4	46%	16%
2.7 Insurance	4.0	55%	13%
2.8 Retirement planning	4.4	48%	16%
2.9 Estate planning	3.9	58%	6%
2.10 Periodic reviews	4.0	58%	15%
2.11 Advice fee and commission disclosure	5.0	32%	24%
3 Strategy			
3.1 Clear explanation of rationale for investment vehicles and asset allocation	4.8	37%	13%

Item	Average score (out of 10)	% Poor or Fail	% Good or Excellent
3.2 Clear explanation of investment risks	4.9	34%	19%
3.3 Does the strategy match the client's needs and objectives	5.1	32%	22%
3.4 Is the strategy easy to understand?	5.1	25%	18%
4 Recommendations			
4.1 Suitability of specific investments in relation to client's needs and goals:			
(a) liquidity and flexibility	5.4	0%	21%
(b) diversity	5.3	22%	24%
(c) cost	5.2	22%	15%
(d) overall	5.1	28%	15%
4.2 Strategy and recommended investments match the client's risk profile	5.4	23%	21%
4.3 Clear justification of client / product nexus.	4.5	45%	6%
4.4 Disclosure of product fees	4.9	29%	20%
4.5 Overall appropriateness of advice	5.1	34%	18%
4.6 Relevant product documentation provided	5.8	41%	52%
5 Other factors			
5.1 Document easy to read and understand	5.3	25%	23%
5.2 Technically sound analysis	5.3	29%	20%
5.3 Client's satisfaction with advice process and the plan	6.1	22%	49%

3.3 Correlation of quality with other factors

This section looks at the correlation between the quality of advice and other factors. The information may be useful in identifying trends in areas of strengths and weaknesses.

Footnotes show the statistical significance of the comparison between 2 groups (taking the sample size into account). For example, a “95% significance level” means there is a 95% probability that there really is a difference between the 2 groups, and a 5% probability that the apparent difference is just a sampling fluke. We have not concluded any difference where the significance is less than 90%. The presence of a correlation does not prove a causal relationship, but it is important information from which people can draw their own conclusions.

Industry sector

Stockbrokers had significantly lower scores (average score 48) than the other industry sectors (average 54).⁵ There were 2 “Good” grades, but 6 of the 13 plans were in the “Poor” or “Very Poor” categories.

In general, many stockbrokers focused on recommended investments and overlooked many of the other issues that are essential in a comprehensive financial plan. For example, stockbrokers scored lower on their assessment of client needs and goals (4.3 out of 10), explanation of investment risks (3.4) and overall appropriateness of advice (4.6).

Banks had 30% of their plans in the “Poor” category (partly due to frequent failure to provide an ASG, which meant an automatic downgrade).

Medium–large planners had the smallest proportion in the “Poor” or “Very Poor” categories (22%) and were responsible for both “Very Good” plans. We only had a small sample of small planners. These were evenly spread between “Poor” and “Good”.

Location

Results for capital cities were slightly higher than regional locations (average 55 vs 50).⁶

Ownership links with product suppliers

About 70% of the planners had ownership links to product suppliers (although some of the others had a house-branded wrap account). There was a minor

⁵ 97% significance level

⁶ 95% significance level

difference between the 2 groups (average score 56 for linked planners vs 51 for non-linked planners).⁷ This minor difference may actually be due to the size of the firm rather than the link, as linked firms tend to be larger.

Years of experience

As a measure of the planner's experience, we noted when the individual planner was first registered as an authorised representative for a securities dealer.⁸ While not a perfect measure, this was considered more reliable than the description in the ASG of "years of experience in the finance industry" which could include years as a bank teller.

The average scores were similar across the 3 groups (pre 1997 = 54, 1997–1999 = 57, post 1999 = 54). Of concern, is that, despite their experience, the long term authorised representatives (pre 1997) still had a high proportion of plans in the "Poor" and "Very Poor" categories (28% of the 68 pre-1997 planners).

This tends to support the government licensing policy of requiring planners with long experience to either demonstrate their competence or update their training.

Certified Financial Planners and Certified Practising Accountants

We noted whether the individual planner had a professional designation such as CFP or CPA.

"Certified Financial Planner (CFP) is an internationally recognised mark. It is the highest professional designation that can be given to a financial planner. CFPs have extensive industry experience and undergone rigorous study. The qualifications gained by CFPs are well above those required by law."⁹

A Certified Practising Accountant (CPA) designation is an accountant who:

- holds an undergraduate degree accredited by CPA Australia;
- has completed the CPA Program (a postgraduate professional study program);
- has 3 years experience in finance, accounting or business;
- undertakes continuing professional development each year.

CPAs do not necessarily work as accountants; they may be full-time financial planners.

⁷ 95% significance level

⁸ Information was drawn from the ASIC database.

⁹ Quote from Financial Planning Association website www.fpa.asn.au

36 of the planners in our sample were Certified Financial Planners and 17 were CPAs (9 planners were both CPAs and CFPs).

The survey showed that planners with higher qualifications had slightly higher scores on average. CPAs had an average score of 60 and CFPs 58 compared to 53 for those with no extra qualifications.¹⁰ 41% of the plans from CPAs were “Good”.

As the table below shows, these differences are not due to longer years of experience.

Table 3.4 Average score by qualification and years of experience

First year as authorised representative	CPA	CFP	Neither CPA nor CFP
2000–2002	-	-	54
1997–1999	66	63	51
pre 1997	58	55	53
Total	60	58	53

It is worrying that 14% of the plans from CFPs and 12% of plans from CPAs were in the “Poor” or “Very Poor” categories.

Accountancy group

In 11 cases, we could identify that the planner was part of an accountancy practice. There may have been others in our sample, but there was no evidence on the written plan or ASG. The overall quality of the accountancy group plans was little different from others.

FPA membership

About 92% of the licensees were principal members of the Financial Planning Association. Their average scores were a little different than non-FPA members (54 vs 52).¹¹

Method of payment

Planners had a range of payment methods for the advice.

¹⁰ 98% & 91% significance level for CPAs and CFPs respectively.

¹¹ No significant difference at 90% significance level

Table 3.5 Summary of payment methods

Payment method	Proportion of plans	Average total score
Commission only	21%	48
Fee and commission	61%	58
Fee only	16%	56

The overall quality was significantly worse if the planner was only paid by commission.¹²

44% of the “commission only” plans were in the “Poor” or “Very Poor” categories for overall score.

52% of the “commission only” plans scored “Poor” or “Fail” for Item 4.5 “Overall appropriateness of advice”, compared to 21% of the “fee only” plans and 26% of the “fee + commission” plans.

Cost of advice

We added the upfront fee and the upfront commission to give a “total initial cost of advice”. The range was \$0–\$17,000. Where the planner charged a mix of fee and commission, the fee was typically less than a third of the total advice cost.

There was some correlation between the cost of advice and the quality.

Plans costing in the range \$0–\$4,000 had a similar average score to plans costing over \$4,000 (54 vs 59).¹³

The amount paid for advice is clearly no guarantee of quality. 24% of the plans costing over \$4,000 were “Poor” or “Very Poor”. The most expensive plan in the survey cost over \$17,000 in commission but was in the “Very Poor” category. On the other hand, 22% of the plans costing under \$2,000 were “Good”.

Amount under advice

Volunteers were asked the total amount that could be subject to advice, such as current superannuation, shares, managed funds, savings, investment properties, etc.

¹² 99.9% significance level

¹³ No statistically significance difference at 90% level

There was no significant relationship between the amount under advice and the quality of advice received.

However, some people with modest savings had difficulty getting any written financial advice at all, despite being willing to pay a fee for advice. In some cases the planner was not interested in taking on the person as a client (presumably because the client was not perceived as profitable enough or the planner was targeting other market segments). In some cases the planner was too busy. In other cases the planner gave some verbal advice (sometimes good, sometimes bad) and suggested they return for a plan when they have more money to invest.

Table 3.6 Investment amount available for advice

	Less than \$100,00	\$100,00 or more
	No. (%)	No. (%)
Plan received — "Borderline" or worse	28 (55%)	35 (48%)
Plan received — "OK" or better	23 (45%)	38 (52%)
Total	100%	100%

Recommended selling existing investments

About 52% of plans recommended selling existing investments. There was no significant pattern with the quality of advice.

Recommended gearing

32% of plans recommended gearing as a strategy. It could be using an existing home as security for a loan or using a margin loan.

There was little difference in the overall quality of advice where gearing was recommended.

Gearing was sometimes recommended where it did not fit the client's risk profile. Where gearing was recommended, 26% of plans (10 out of 39) were in the "Poor" / "Very Poor" categories for Item 4.2 "Strategy matches client's risk profile", compared to 21% of plans without gearing.

Recommended wrap accounts or master trust

62% of plans recommended some kind of wrap account or master trust. This did not include fund of fund investments, funds with a limited range of investment options or mere accounting services.

There was no pattern with the quality of advice.

Wrap accounts or master trusts were recommended just as frequently for people with <\$100,000 as for people with larger amounts.

Investments with related product suppliers

We recorded what percentage of investment assets were recommended to go into an investment *vehicle* owned by a related entity. The vehicle may be a managed fund, a wrap account or a master trust. Within a wrap account or master trust, the money may be allocated to a diverse range of investment managers.

Of the planners related to a product supplier, the majority of plans (67%) recommended at least some money be invested *via an investment vehicle* owned by a linked company. Some of the other plans did not involve any money being invested. 56% of the planners related to a product supplier recommended that 100% of clients' new investments go into an investment vehicle run by the linked product supplier (eg managed fund, wrap account).

Of the planners related to a product supplier, we looked at what percentage of investment assets were *managed* by a related entity. 61% of these plans had some assets managed by a linked product supplier. In 22% of these plans, it was 100% of assets. This may represent poor diversification.

Client satisfaction

There was some correlation between the client's satisfaction with the planner and the judges' assessment of the written plan. Where the client rating was <4.5 out of 10, the average score for the plan was 48 out of 100. Where the client rating was >6.5 out of 10, the average score for the plan was 58 / 100.

3.4 Comparisons with other surveys

1998 ASIC/ACA quality of advice survey

While comparison with the 1998 ASIC/ACA survey is useful for overall assessments of industry trends, the scores of the two surveys are not strictly comparable because of slight modifications to the assessment criteria and different grade categories.

A broad comparison shows that the overall quality of advice has not changed significantly since the last survey. Most of the weaknesses identified in the last survey still apply. A significant proportion of the plans still received unacceptable grades. Stockbrokers again graded poorly.

In the last survey, the increased use of financial planning software seemed to have helped improve adherence with key compliance elements. This time, however, the panel noted that the careless use of software and templates lead to some plans that ignored individual needs or gave generic explanations.

The basic disclosure of commissions has improved. However, one third are still “Poor” or “Very Poor”, and disclosure beyond basic components is still weak.

It appears that there has been a small improvement in the explanation of investment risk. This may have been affected by the investment climate at the time of the survey, with a major downturn. The FPA has also stressed the issue to its members following the last survey.

FPA National Quality Assessment Program

Many of the problem issues identified in this survey were also identified in the Financial Planning Association's National Quality Assessment Program.¹⁴ The 2002 NQAP report noted a number of weaknesses that had been detected, including:

- Non-disclosure of adviser benefits and incentives,
- Unclear disclosure,
- Non-disclosure of links with product suppliers,
- Inadequate completion of 'fact find' by planners,
- Inadequate training on issue of compliance and technical competence,
- Inadequate tailoring and customisation of advice,
- Inadequate disclosure of whether advice is limited or comprehensive,
- Misunderstanding of risk profiling assessment,
- Inadequate explanation of 'portfolio review of monitoring services'.

The report did not deal with the frequency of the various weaknesses.

¹⁴ A report 'FPA Guidance on the NQAP Findings' was released at the FPA Convention in November 2002.

Section 4 Conclusions

4.1 Broad observations

Overall quality

The overall quality of the plans was disappointing.

Only half the planners provided a financial plan that was judged acceptable, when measured against good practice standards and the consumer's request for a comprehensive plan. Another quarter of the planners provided borderline plans with significant weaknesses.

At least 14% did not meet the minimum legal standards. Legal non-compliance is clear where an Advisory Services Guide was not provided (14% of plans). Another 5% of plans did not show that they complied with the "appropriate advice" law, but this can rarely be determined definitively from the written plan alone.

"As a financial plan this document fails on almost every count. In reality, the document is simply a series of modelling schedules with a brief appended letter. It could not be considered as a comprehensive financial plan." – Judge 5

About a different plan:

"Poor excuse for an advice. Grossly short on details." – Judge 2

Quality control

A comprehensive financial plan is about a disciplined process of:

- discovering the client's needs and goals;
- exploring strategies;
- recommending actions;
- estimating the extent to which these will address the client's goals; and
- communicating this to the client so he or she can decide whether to adopt the advice.

While there were some excellent individual plans, the overall quality of plans was highly variable, even within the one company. It is apparent that many companies have inadequate systems to consistently produce financial plans that meet good practice standards and, in some cases, legal requirements. A quality control

system includes staff training, the system for producing the plan and the process for checking quality before it is finalised.

Far too many plans had simple omissions and mistakes, but a low score is not the result of a one-off human error. It reflects the whole approach to the planning task.

“Where is the quality review, audit, training and supervision here? This is appalling.” – Judge 6 (commenting on a “Very Poor” plan)

Limited advice

The most noticeable market trend was that a significant proportion of plans were not *comprehensive* financial plans. This is despite the fact that all volunteers requested a comprehensive plan. Two observations are pertinent.

First, many planners gave limited advice but did not disclose this clearly (or at all). In other words, consumers were not getting the service they asked for and/or expected, but may not have been aware of this. Advice is more likely to be inappropriate if it does not look at all the client’s circumstances and goals.

“[These] clients want to educate children, purchase vehicle, etc. Plan doesn’t address any goals other than retirement ... but plan does not state that the client is seeking specific advice confined to the issue of super.” – Judge 1

Second, the survey suggests that the dynamics of the market have changed somewhat since the last survey. When consumers approach planners, they are now less likely to get comprehensive advice early in the process. This particularly applies to clients with modest wealth and planners working on commission. Planners now seem to be more selective in the “market segments” they target. Some planners specialise in wealthy clients. Some targeting a mass market provide a simpler, more restricted service.

Stockbrokers

Stockbrokers stood out as having a significantly lower average quality than other industry sectors. When faced with a request for a comprehensive financial plan, some brokers basically gave a list of share recommendations, with little supporting strategy or rationale. However, when they approach a financial planning task properly, some plans from brokers were quite good.

The problem with stockbrokers was also observed in the 1998 survey. Broking firms need to decide whether they want to be in the financial planning market, and if so, to do it properly. They need to clearly distinguish between financial planning services and simple investment advice.

Non-impartial advice

A common observation by several judges was that clients' interests did not appear to be the sole factor in the plan strategy or product selection. They characterised this practice as "*commission-driven product selling, not impartial advice*".

"... like many others, [this plan] is just another 'selling tool' for managed funds" – Judge 4

"This generic pro-forma style plan is [a] financial needs analysis / sales justification document. " – Judge 2

These plans often gave no reason why the recommended course of action was preferred, or the reasons appeared skewed to justify the product recommendation.

"Plan seemed to focus straight to wealth accumulation via the advisor's company master trust. No explanation as to why, the pros and cons, and how this recommendation was going to fully meet the client needs and objectives." – Judge 9

Recommendations frequently overlooked options that may be more cost-effective:

- adviser elects to waive product entry fee — rarely recommended;
- low cost superannuation funds — never recommended;
- pay off mortgage rather than invest cash — rarely recommended;
- salary sacrifice — recommended in a minority of plans.

About half the plans recommended selling at least some of the client's existing investments.

The combination of commission-based remuneration and management sales targets sits uncomfortably with good practice and professional advice.

"The main recommendation was to rollover client's superannuation into a fund [master trust] from which the advisor receives commissions. No analysis or discussion to justify this. 'Churning' in a newer guise." – Judge 7

"This plan is unusual in that it exhibits some degree of advice integrity, a characteristic not commonly evident in many other plans reviewed. " – Judge 4

There appears to be a mismatch between what the consumers thought they were getting and what they actually received. Our consumer volunteers asked for a *comprehensive* financial plan. In addition, consumers may assume that the financial planner's role is to give them the best advice (although this is not required by law). Our judges found that about half the plans were not a

satisfactory comprehensive financial plan. Looking at the consumers' feedback, many were unaware of the shortcomings in the plans they had received.

Poor communication

The purpose of advice is to provide reasoned recommendations so consumers can decide whether to take the advice. Some consumer volunteers clearly did not feel the plan had succeeded in doing this. Some plans fell down as effective communication (eg one volunteer wrote *"I now have 3 plans, who can explain them to me?"*) Judges also commented that many plans were unclear, poorly written, swamped with generic material and difficult to follow.

"Too much generic material - much of this has no relevance to the particular strategies recommended in the plan." – Judge 3

"The relevant disclosure statements are a 'nightmare' to understand." – Judge 4

On the other hand, some plans (even simple, low cost plans) were well written and clear.

"An excellent plan - planner considers more than one strategy + executive summary was very comprehensive." – Judge 1

"This plan is easy to read and displays client objectives well." – Judge 3

"Well written and client-specific, recommendations are soundly based and well considered. Contains fluency and good structure." – Judge 4

Compared to the last survey, more plans appeared to contain standard, pre-written material. While this may lead to effective communication in some cases, it also creates the potential for new problems. Some plans had sections that were clearly copied from another plan with little thought, as even the client's name had not been changed.

"Clearly a cut and paste job." – Judge 4

Many plans also used generic material (often lengthy) with no indication how it related to the client's situation. Better plans clearly distinguished between client specific advice and educational material (sometimes in an appendix or separate document).

Some other plans had inadequate explanation of the rationale for the recommendations. Consumers were understandably baffled when they received 3 plans with quite different recommendations, but no apparent reasons why each recommendation was preferred.

“This is not a plan but a bunch of computer pages stuck together. No concepts, no explanations, no benefits, no product analysis, ... no planning or review.” – Judge 9

Consumers appeared to get better quality advice when they already knew enough to put specific options for the adviser to assess.

The quality of communication is a major issue that the industry needs to address. It is central to the 'value added' by a financial planner for the client. It is also central to compliance under FSRA, as key information in a statement of advice has to be presented in a 'clear, concise and effective manner'.

Ensuring effective communication is not an easy task. It will involve considerable work by industry associations, individual planners, educators, licensees and planning software designers.

Comparisons with future standards

For our survey, the plans were judged on pre-Financial Services Reform Act (“FSR”) standards. The FSR standards will apply from whenever the principal converts to a new licence under FSR. Principals have until 11 March 2004 to convert.

Under FSR, several good practice standards become legal requirements. While the principles remain the same (disclosure, appropriate advice, etc), FSR is more specific about what information advisers must provide in writing. This applies particularly to the contents of a Statement of Advice.

A large proportion of financial advice in this survey would not comply with upcoming FSR requirements in some respect.¹⁵

Many plans did not include sufficient information about the basis on which the advice was given, sufficient to allow the consumer to decide whether to take advice or not,¹⁶ such as:

- the range of products being advised upon;
- the product or strategy research process (use of independent research, etc);
- how the recommended strategy and products meet the client's needs, goals and risk profile; and
- what options were considered.

¹⁵ see Corporations Act Part 7.7

¹⁶ Corporations Act s947B or 947C

Very few plans included information about the costs and lost benefits of switching from an existing product.¹⁷

Some plans did not disclose commissions on insurance products.

The advice in many plans was not “worded and presented in a clear, concise and effective manner”.¹⁸

A few planners gave advice only verbally, without a written statement of advice.

Common practices in financial planning will therefore have to change significantly to meet FSR standards. These standards apply from whenever the licensee converts to an AFS licence (by March 2004 at the latest).

Compliance with FPA rules

The survey revealed widespread non-compliance with FPA rules by FPA members.

The Financial Planning Association requires its principal members (representing about 90% of the industry) to comply with the FPA's Rules of Professional Conduct. Many rules mirror the law, but some go beyond legal requirements. For example, the FPA requires the disclosure of commissions on insurance and margin loans.

This non-compliance raises the issue of what further steps the FPA should take to monitor and ensure compliance with its rules. The FPA has already announced a number of educative projects aimed at raising the overall quality of advice. Nevertheless, it is open to question whether it could take stronger action where specific members cannot demonstrate on-going compliance with its compulsory standards.

4.2 ASIC action

Ongoing action

Investment advice is one of the important financial sectors that ASIC supervises as part of its routine work. ASIC's work covers:

- policy issues and industry guidance
- licensing
- enforcement

¹⁷ Corporations Act s947D

¹⁸ Corporations Act s947B(6) or 947C(6)

- consumer education.

In the past two years, ASIC has removed 62 financial advisers from the industry and a further 10 have received jail terms.

Compliance projects are underway looking at systemic issues in a range of firms, including:

- Checking for inappropriate advice within firms specialising in tax-driven, high commission products;
- Internal dispute resolution procedures - ensuring firms inform clients about internal procedures and, where complaints are not resolved, about external dispute resolution procedures.
- Paying higher commissions for recommended in-house products (without proper disclosure)
- Lack of staff supervision
- Inappropriate superannuation switching

The booklet *“Don’t Kiss Your Money Goodbye”* assists consumers to avoid traps in the financial planning market place. This is published jointly with the Financial Planning Association.

In December 2002 we released a Policy Proposal Paper, detailing ASIC’s interpretation of regulatory requirements about financial advice.

Additional actions arising from the survey

In light of the survey findings, ASIC is commencing several extra activities:

- We will be meeting with all firms with “Very Poor” plans and firms where more than one planner failed to provide an Advisory Services Guide.
- We will be requiring some licensees to certify their compliance with relevant legal obligations, including the ‘know your client’ rule and commission disclosure.
- In one or two cases, we will be following up specific licensees about their failure to adequately supervise advisers.
- We will be refining our industry information program to ensure firms are aware of the higher advice standards required by the Financial Services Reform Act.

We will also be holding discussions with the industry on the best way to improve communication standards in plans.

In parallel to the Quality of Advice survey, ASIC conducted an additional survey on the nature of interaction between consumers and financial advisers in the main planning meeting. We focused on the verbal discussions, including coverage and understanding of topics and the consumer's reaction to the discussion. The research report will be released shortly.

Appendix 1 Assessment panel

The assessment panel comprised 9 judging positions. Two of the judges needed to share the work with an alternate due to workload pressures. The panel had a mix of experienced practitioners and compliance experts, a mix of FPA and non-FPA people, and a spread across industry sectors (large firms, small firms, a bank). Five of the panel members were nominees of the Financial Planning Association, although they performed their role in an individual capacity.

Kathryn Bowler (Alternate - Carolyn Mooney)

At the time of the survey, Kathryn was Manager, Financial Planning, CPA Australia. She was previously a financial planner before joining CPA. Carolyn is Financial Planning Policy Adviser, CPA Australia.

Paul Brady CFP

Managing Director of Brady & Associates, a small financial planning company. On FPA Board as a Practitioner Member. Past Chair of the FPA's Education Committee and of the Sydney Chapter of the FPA.

Ian Gillies CFP

Manager, Private Clients, UBS Warburg, Melbourne. Chair of the FPA committee supervising Diploma of Financial Planning Unit 8 — Financial Plan Construction and Review.

Christina Kalantzis (Alternate - Catherine Crack)

Christina is Manager, Policy & Professional Standards, Financial Planning Association. Catherine is Manager Professional Standards, Financial Planning Association.

Heather Loewenthal

Head of Compliance, Business & Consumer Banking, Westpac. Vice President, Australian Compliance Institute. Heather was also on the panel in the 1998 survey.

Phillip Osborne CFP

Hillross Financial Services Limited, Melbourne. Member of the FPA committee supervising Diploma of Financial Planning Unit 8 — Financial Plan Construction and Review.

Peter Roan CFP

Garrisons Financial Planning, Orange. Member of FPA's Education Committee

Brett Walker

Director, FSI Consulting Pty Ltd. Brett has been the principal of FSI for 4 years, providing compliance and quality assurance services to retail planners. Brett was also on the panel in the 1995 survey.

Max Weston

Consultant with 30 years experience in financial planning. Founder of Godfrey Weston Financial Planning and past Council member of the FPA.

Appendix 2 Scoresheet

Item	Judge's score	% of total score
1 Advisory Services Guide information: (scored by research assistant)		
1.1 Whether ASG provided		3.0%
1.2 Disclosure of status of adviser		3.0%
1.3 Disclosure of adviser's relationship to product providers		3.0%
1.4 Remuneration disclosure		3.0%
1.5 Disclosure of complaint mechanisms		3.0%
<i>Sub-total</i>		15.0%
2 Plan structure: are the following elements described and analysed?		
2.1 Disclosure of extent to which advice is limited (needs, brands, assets)		1.4%
2.2 Client's preferences, needs, objectives, risk profile, problems, time frames		1.4%
2.3 Cashflow position — income needs, expenditure, cash reserves (current and future)		1.4%
2.4 Assets and liabilities		1.4%
2.5 Current investment / portfolio position		1.4%
2.6 Tax position		1.4%
2.7 Risk protection (life, income insurance)		1.4%
2.8 Retirement planning (superannuation and pensions)		1.4%
2.9 Estate planning		1.4%
2.10 Periodic review (continuing services and related costs)		1.4%
2.11 Advice fee and/or commission disclosure in plan		1.4%
<i>Sub-total</i>		15.0%
3 Strategy		
3.1 Clear explanation of rationale for investment vehicles and asset allocation		6.0%
3.2 Clear explanation of investment risks		6.0%
3.3 Does the strategy match the client's needs and objectives		7.0%
3.4 Is the strategy easy to understand?		6.0%
<i>Sub-total</i>		25.0%

Item	Judge's score	% of total score
4 Recommendations		
4.1 Suitability of specific investments in relation to client's needs and goals:		
(a) liquidity and flexibility		—
(b) diversity (asset classes, management, style, etc)		—
(c) cost		—
(d) overall		3.0%
4.2 (a) strategy and recommended investments match the client's risk profile		3.0%
(b) if marked down, was the plan (1) too conservative or (2) too risky?		—
4.3 Clear justification of client / product nexus.		5.0%
4.4 Disclosure of product fees		3.0%
4.5 Overall appropriateness of advice		8.0%
4.6 Relevant product documentation provided (scored by research assistant)		3.0%
<i>Sub-total</i>		25.0%
5 Other factors		
5.1 Is the overall document easy to read and understand?		8.0%
5.2 Is analysis technically sound (eg accurate calculations, accurate fact find)		4.0%
5.3 Client's satisfaction with advice process and the plan (scored by ACA)		8.0%
<i>Sub-total</i>		20.0%

Scoring system

Fail	Poor	Adequate	Good	Excellent	Not applicable
0 1 2	3 4	5 6	7 8	9 10	99

Judge's comments:.....

Appendix 3 Specific aspects of plans

1 Advisory Services Guide

1.1 Provision of ASG

Providing an Advisory Services Guide (ASG) has been a legal requirement since 1998. However, 14% of the consumer volunteers did not receive an ASG. Banks (20% scored “Fail” for this item) were the worst offenders.

A couple of planners allowed their client to merely sight the ASG but did not give them a copy to take away. One adviser told the client, “*You don’t need any of that written stuff*”.

One client received an ASG, but then the adviser switched firms and the advice eventually came from a second adviser in the new firm (without a new ASG).

Failure to provide an ASG was considered a “critical error” and to the plan was automatically downgraded overall to “Poor”.

1.2 ASG — Disclosure of adviser status

Where an ASG was provided, the adviser’s status was generally well disclosed. For banks, 40% of plans scored “Fail” or “Poor” for this item.

Problem areas included:

- where the adviser represented a life broker — not explaining what this meant (one adviser described himself in one place as a life agent and elsewhere as a life broker);
- confusing disclosure at times where the adviser worked for a local company but was an authorised representative of a larger dealer group; and
- disclosure by some companies of the adviser’s personal details by leaving a space in the ASG to insert a business card. However, many of these did not contain a business card by the time they reached ASIC (and it was unclear if they ever did). This does not seem a satisfactory process for the consumer and creates difficulties for the principal in monitoring compliance.

Better ASGs provided:

- information about the adviser’s experience and qualifications; and

- specific information about what areas the adviser was authorised to give advice on. The best ASGs made this information even clearer by saying what the adviser was *not* authorised to give advice on (eg tax driven products, social security, etc).

1.3 ASG — Disclosure of relationship to product suppliers

Where the principal had a relationship with a product supplier (eg a fund manager is the parent company), this was generally well disclosed.

However, a preference for in-house products was not always disclosed in advance. In contrast, good ASGs disclosed this prominently, such as this example from IPAC:

Generally, we only provide investment recommendations for unit trusts, superannuation and retirement products offered by IPAC through the [IPAC wrap account]. ... Other investments will be recommended where client needs require.

1.4 ASG — Disclosure of adviser remuneration

All ASGs included material on the adviser's remuneration, as required by legislation. However, the information from small planners and stockbrokers was often not as clear.

60% scored "Good" or "Excellent" for this item.

1.5 ASG — Disclosure of complaint mechanisms

Almost all ASGs included material on complaint mechanisms, as required by legislation.

79% scored "Good" or "Excellent" for this item.

2 Plan structure

2.1 Disclosure of limited advice

If the adviser is providing advice that is limited in some respect, the adviser should disclose this in the plan. 34% of plans scored "Fail" or "Poor" for this item.

However, many of the plans focused on a limited range of issues without agreement from the client. Brokers scored lower on this item, with 8 out of 13 scoring "Fail" or "Poor" for this item.

Problems included:

- planners apparently limiting the scope of the advice to a particular issue without communicating this to the client; and
- limited advice where the client asked for a comprehensive financial plan. (Consumer volunteers had been instructed to ask for a comprehensive plan, and our post-survey interviews indicate they did ask).

2.2 Client's preferences and needs

A plan ought to restate the client's preferences, needs, risk profile, etc. This enables the client to correct the planner if there has been a misunderstanding. 25% of plans scored "Fail" or "Poor" for this item. Brokers were particularly bad, with 8 out of 13 plans scoring "Fail" or "Poor".

Problems included:

- some planners seemed to have ignored or over-ridden the client's needs or risk profile because they had a specific strategy in mind (eg gearing). One planner told the client, "*The risk profile survey rates you as 'moderate', but I want to recommend gearing so I will classify you as 'moderately aggressive'*";
- some plans put the client in a risk category with no explanation of how the conclusion was reached;
- client's needs were not addressed early in the body of the plan (eg product recommendations were addressed first);
- client's preferences were not adequately discussed in the plan; and
- incorrect health and risk profile.

2.3 Cashflow position

About 36% of plans scored "Fail" or "Poor" for this item. Brokers rated lowest, with 7 out of 13 scoring "Fail" or "Poor". Small planners also scored poorly.

Problems included:

- although cashflow is often critical where gearing strategies are considered, several plans ignored cashflow or calculated it incorrectly (eg ignoring interest costs, tax liability);
- incorrect calculations;
- future expenditure requirements not taken into account in calculations;
- investment earnings projected past the date when the investment had been liquidated for living expenses; and
- only very short term cashflow projections made.

2.4 Assets and liabilities

Most plans scored well on this item, with 81% scoring “Adequate” or better.

Problems included:

- only listing some assets;
- showing interest earned in cashflow but not taken into account for tax liability.

2.5 Current investments / portfolio position

Most plans also scored reasonably on this item, with 81% scoring “Adequate” or better. Problems included:

- failure to discuss all of the client’s investments;
- inadequate investigation of client’s existing assets (eg asset allocation within existing superannuation policies);
- lack of analysis on the gearing features of current investments.

2.6 Tax position

Many plans scored poorly on this item, with 46% scoring “Fail” or “Poor”. The low scores were spread across all industry sectors, but banks and small planners scored lowest.

Problems included:

- tax issues not addressed at all or inadequately addressed;
- impact of Capital Gains Tax frequently not considered when investments were recommended to be sold;
- impact of new recommendations on client’s tax position not considered;
- tax implications of margin lending often not adequately explained; and
- out-dated information on tax thresholds used.

2.7 Risk protection and insurance

Many plans scored poorly on this item, with 53% scoring “Fail” or “Poor”. Brokers and small planners were even worse, with about two thirds scoring “Fail” or “Poor”.

Problems included:

- failing to consider insurance needs at all;
- failing to recommend insurance where it was appropriate;

- quoting a recommended cover level (“\$500,000 life insurance”) with no explanation of how the adviser arrived at that figure;
- ignoring the existing insurance cover under superannuation policies, or the potential for cheap extra cover under such policies;
- recommending insurance products but failing to provide product information;
- failing to disclose commissions; and
- using too much generic material.

2.8 Retirement planning

Many plans scored low on this issue, with 48% graded “Fail” or “Poor”. Medium–large chains did better than the other sectors.

Problems included:

- no thorough discussion of retirement planning options;
- too much generic material used;
- client’s specific request about retirement planning not discussed;
- no analysis or review of superannuation position; and
- lack of clarity about whether social security considerations had been taken into account.

2.9 Estate planning

This was one of the worst aspects of the plans, with 58% scoring “Fail” or “Poor”. Most plans had no reference to estate planning at all. Some mentioned “*get a will if you don’t have one*”, but did not ask the client if there was a current will or what it said. Brokers were worst, with 77% scoring “Fail” or “Poor”.

Other problems included:

- too much generic material used; and
- important issues not identified (eg clients should have been advised to review that will which were drafted 25 years ago).

2.10 Periodic reviews

No financial plan can be “set and forget”. Plans should recommend action to periodically review a financial plan. Most plans rated badly on this, with 58% scoring “Fail” or “Poor”. Banks and stockbrokers were particularly bad, with about 70% scoring “Fail” or “Poor”.

This is a particularly serious problem for stockbrokers, as they tended to recommend direct share portfolios that would require frequent monitoring.

Problems included:

- review not addressed at all or addressed superficially;
- unclear cost disclosure; and
- too little information about the scope of the service.

2.11 Advice fee and commission disclosure

For this item, judges were only looking for obvious omissions. They were not able to verify the accuracy of the commission disclosure. Nevertheless, 32% of plans scored “Fail” or “Poor”. Banks (with only 15% scoring “Fail” or “Poor”) were significantly better than the other sectors. Brokers were clearly the worst, with 9 out of 13 scoring “Fail” or “Poor”.

Problems included:

- Some plans used complex tables that included product fees, fee rebates, dealer commission and adviser commission, with a mix of % and dollar figures. Some disclosure only made sense if the reader was familiar with industry jargon such as trailing commission. Others used confusing terms like “brokerage” to disclose commission;
- Disclosures were found towards the end of the plan in an Appendix rather than in the body of the plan;
- Of the 21 plans that recommended specific margin loans (not just a gearing strategy), only 8 disclosed any commission from this. Commission is typically 0.25–0.55%. Disclosure is required by FPA rules and may be required by the Corporations Act;
- Commission from insurance recommendations was often not disclosed; and
- Some plans were suspiciously silent on “soft commissions” and volume bonuses (while others made very clear disclosure on these issues);

3 Strategy

3.1 Rationale for investment vehicles and asset allocation

Considering the importance of this item, the average score was low with 37% of plans scoring “Fail” or “Poor”. Only 13% scored “Good” or “Excellent”. Brokers did worse on this item than the other sectors (62% scoring “Fail” or “Poor”). The

judge's comments suggested many plans simply recommended a fund or funds, with no indication why they suited the client.

Other problems included:

- failure to consider more than one strategy;
- no consideration of existing investments and vehicles; and
- connection between the risk profile and the asset allocation often either not made or when it was, not explained.

3.2 Explanation of investment risks

For this item, 34% of plans scored "Fail" or "Poor". Brokers were particularly bad, with 9 out of 13 plans scoring "Fail" or "Poor". This result is all the more worrying given the plans were obtained during a period of dramatic market declines, when investment risk was a topical issue.

Explanation of investment risk is particularly important when negative gearing or direct share purchases were recommended, or when the client is dependent on the income.

Problems included:

- no evidence that this element had been specifically addressed;
- too much generic material; and
- no discussion of risk profile to support recommended allocations in investments.

3.3 Strategy matches client's needs and objectives

Judges were assessing whether the plan explained how the strategy matched the client's needs and objectives.

On this critical item, 32% of plans scored "Fail" or "Poor". Brokers performed worst, with 7 out of 13 scoring "Fail" or "Poor".

Problems included:

- plan did not address all of the client's specific goals;
- plan did not say whether the proposed strategy would meet the client's specific goals; and
- self managed superannuation funds (SMSF) were sometimes proposed with little justification in terms of the client's specific circumstances. One plan recommended a SMSF despite listing one of the client's goals as

“simple administrative arrangements”. Some judges suspected that SMSFs had been recommended so the adviser would get ongoing payment for administration work.

3.4 Strategy is easy to understand

This was another mediocre result, with 25% of plans graded “Fail” or “Poor”. Brokers did particularly badly, with 6 out of 13 plans graded “Fail” or “Poor”. For some of the brokers and some others, plans simply recommended purchases but lacked any explicit strategy.

Problems included:

- many plans did not communicate the strategy effectively; and
- it was difficult to understand what was being recommended and difficult to understand why it was being recommended.

4 Recommendations

4.1(a) Suitability of investments — Liquidity and flexibility

All plans were at least adequate on this item. The use of master trusts may have aided flexibility. Few illiquid investments were recommended.

4.1(b) Suitability of investments — Diversification

Most plans were at least adequate on this item, with 22% of plans graded “Fail” or “Poor”. Brokers did badly with 46% graded “Fail” or “Poor”. Their recommendations tended to lack diversification in either asset class or investment manager.

4.1(c) Suitability of investments — Cost

The scores for this item were closely bunched around the middle, with 61% of plans graded “Adequate” and 22% “Fail” or “Poor”.

Many plans did not recommend the lowest cost option available. As low cost options pay no commission, this raised some suspicions about the influence of commission on advice. For example, no adviser recommended switching to a non-profit, industry superannuation fund. Only one plan recommended an index fund. Many plans recommending retail life insurance did not compare the cost of insurance via the client’s existing superannuation fund.

4.1(d) Suitability of investments — Overall

Judges were assessing whether the plan explained how the investments suited the client.

This critical item had a modest average score (5.1), with 31% of plans scoring “Fail” or “Poor”. Brokers were clearly the worst on this item (8 out of 13 scoring “Fail” or “Poor”). Medium–large dealer groups were best with 80% scoring at least “Adequate”.

Problems included:

- high ongoing fund manager fees not considered;
- lack of analysis about the suitability of specific investments and how these investments relate to the achievement of the client’s needs and goals; and
- obligations and associated costs of handling a self managed super fund not made clear.

4.2 Strategy and investments match the client’s risk profile

On this item, 23% of plans scored “Fail” or “Poor”. A disproportionate number of the “Fail” or “Poor” scored involved negative gearing. Brokers were worst, with 6 out of 13 scoring “Fail” or “Poor”.

Problems included:

- some plans had no real discussion of risk profile at the outset, making it difficult to see if the strategy and investments matched it;
- risk profile stated but not substantiated; and

More plans were scored down for being too risky than for being too conservative.

4.3 Justification of client / product nexus

For this critical item, 45% of plans scored “Fail” or “Poor”. Brokers and small planners were worst, with about two thirds scoring “Fail” or “Poor”.

As for some other items, the judge’s found many plans simply recommended a fund or funds, with no indication *why* they suited the client. Many plans did not link the recommendation back to show how it would achieve the client’s stated goals.

Problems included:

- not enough comparison between products;

- not enough analysis of the product and the respective benefits it will give to the client;
- not enough evidence that the recommended product represents the superior option for the client; and
- discussion only covered some of the products recommended.

“This plan pursues a strategy wherein the bulk of client monies are ‘moved’ to new investments which happen to be associated with in-house products. In doing so, no regard is given to the comparative merits of existing versus new investments.” – Judge 4

4.4 Disclosure of product fees

For a simple item, this did not rate highly, with 29% of plans scoring “Fail” or “Poor”. Banks did well (with 95% scoring at least “Adequate”) but brokers did badly (with 75% scoring “Fail” or “Poor”).

Some plans did not summarise product fees, meaning the client may need to refer to 6 or 8 different product prospectuses (each 40 pages) to discover the fees.

There was a noticeable problem with fee disclosure for wrap accounts and master trusts. Due to the multiple layers of fees (investment manager, wrap/trust manager, adviser fee), it was rare for consumers to get an overview of the cost. This is particularly worrying, as lower cost was one of the reasons for recommending these products. In some cases the costs may have been higher than for the current investment.

4.5 Overall appropriateness of advice

This was somewhat of a “catch-all” item. 34% of plans scored “Fail” or “Poor”. This was generally because plans did not show *why* the proposed action was appropriate to the client’s needs. Some did not even show whether the proposed action would meet the client’s stated goals.

4.6 Relevant product documentation provided

Where plans recommended a product, the relevant Product Disclosure Statement (PDS) should be provided to give more detail. Better plans also included a summary from an independent research company. 41% of plans scored “Fail” or “Poor”. Small planners and banks scored best. Brokers scored worst, with 8 out of 13 “Fail” or “Poor”.

Problems included:

- no relevant product documentation provided;

- too much material or irrelevant product material provided; and
- no independent third party research given.

5 Other factors

5.1 Document easy to read and understand

Overall, 25% of plans scored “Fail” or “Poor” for this item. Brokers were the worst, with 6 out of 13 plans scoring “Fail” or “Poor”. The judges had to read the entire plan, so they were very aware of the shortcomings in presentation. ASIC staff who had to extract information from each plan reported major difficulties as well.

Problems frequently reported included:

- lack of an executive summary;
- unclear expression;
- frequent use of generic material (often lengthy) with no indication how it related to the client’s situation. In some “cut and paste” sections even the client’s name had not been changed;
- no table of contents and/or page numbers; and
- use of industry terms and concepts that the client may not understand.

5.2 Technically sound analysis

Judges did not undertake a detailed check of the calculations in each plan. However, the plan was marked down where mistakes were noticed. 29% of plans scored “Fail” or “Poor”. A wide range of problems was noted, with many “one-off” errors.

Common problems included:

- inaccurate fact-find;
- information inconsistent within the plan;
- incomplete assessment of assets and liabilities; and
- unreliable assessment of cash flow position.

5.3 Client feedback — Overall satisfaction with adviser and the plan

The average score was 6.1 out of 10. Only 25% scored less than 5 out of 10.

Clients also provided commentary on their experience with the planner. This information suggested that consumers judged 'quality' on a limited range of

factors. Most commented on issues like the planner's demeanour and office, the prompt time to produce a plan and how accurately the client's details were recorded. Many consumers had not detected where their plan had serious gaps or shortcomings, which is understandable given the average consumers' knowledge about financial planning processes.