[Advice fees but no service: a question of criminal law]

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The threat to vertical integration has receded but financial advice is under attack. Ongoing fees underwrite the economics of advice, but if services are not delivered, a crime may have been committed.

The final report of Australia's Financial Services Royal Commission was released on Monday; on Tuesday the share prices of banks and wealth managers soared by 3-10%. That was the sound of the market saying that when it came down to the big calls, the Commissioner squibbed it.

As highlighted in our Citylogue preview, the interim report had identified two critical questions to be answered in the final report:

- **How do you prevent financial incentives from corrupting the advice given to consumers?**
- **Given that vertical integration (VI) facilitates this outcome, do you need to structurally separate advice from product manufacture and sales?**

The answers when they came were underwhelming. Keep in mind that many witnesses called to the Commission were excoriated in something close to a show trial (rules of evidence do not apply in a Royal Commission); careers of CEOs and board directors were ended. So expectations of major reforms were high.

Yet the recommendation for remuneration of front-line staff was no more than an annual review of the design and implementation of remuneration systems.

And the big one – vertical integration – went into the "too hard" basket. Having breathed fire, brimstone, and structural separation, by the final report the Commissioner was talking about changes already in train, the panacea of technology, and the fog of the future. In the end he pulled back, kicking vertical integration into (very) long grass with a recommendation for 5-year reviews.

No wonder financial stocks soared. Crisis over.

Not exactly. For some the trouble has just begun – and with lessons for the UK.

Trouble looming for financial advice

And while vertical integration was not directly attacked in the recommendations, one of the critical links was – **the ability to deduct ongoing fees from client accounts** (particularly from pension platforms). In the Commissioner's view, this is at the heart of the "fees for no service" issue. Arguments that the failure to deliver or evidence delivery of fees for service was sloppy work or poor systems rather than intentional deception were dismissed; in the Commissioner's view this was theft, raising issues of criminal law.

Key aspects of his comments and recommendations included:

- The **role of advice is principally about investment selection** rather than being holistic in nature, or even about retirement income.
- Accordingly, **only fees for advice about investments should be deductible from client accounts** (anything else should be paid directly by clients).
- The need for ongoing advice of any kind should be rare; and in any event **clients should have to reconfirm annually their acceptance of fees for specified services.**

In our view this is an antiquated view of advice which would take financial planners back to being stockbrokers or becoming investment managers (which would also spell the end of outsourced DFMs). Advice would fall in quality and become much more limited in its scope.

At this stage these are only recommendations, but both sides of politics have pledged to implement the recommendations. As they stand this would destroy the economics of most financial advice businesses.

Lessons for the UK

There are some clear lessons for those in the UK wealth industry wishing to avoid this scenario:

- **Advice providers:** ongoing fees directly charged to clients will be in the spotlight. **Services need to be clearly specified and actually delivered.** Obvious, but perhaps not obvious enough.
- **Wrapper providers (especially platforms)**: product providers allowing advice fees to be charged to client accounts are not just revenue collectors. **They also have an obligation to audit the delivery of advice services for the fees which they collect for advisers.** We know from our conversations with UK product providers that this is far from universal – it will have to change.
- **Asset managers:** where allowing advice fees to be charged, the above also applies. Where asset managers are supplying products via wrappers owned by major distributors, **there is perhaps now an onus to understand how advice fees are being charged and delivered.** At present, asset managers have no line of sight to advisers unless a platform chooses to share data – far from ideal in this context.

The potential threat to UK vertical integration should abate. But one of its key tenets – charging advice service fees to client accounts – is just as common in the UK as Australia. As UK industry participants (re) vertically integrate, they have the opportunity to do so in full view of the train crash that has been the Australian market. With the FCA having signalled it will review ongoing advice fees in 2019, the learnings should be heeded.

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