THE HAYNE ROYAL COMMISSION AND FINANCIAL PLANNING ADVICE: A REVIEW OF THE IMPACT ON THE OPERATING MODEL OF FINANCIAL ADVICE FIRMS

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ABSTRACT

The recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry outlined a new approach to disclosure, review and remuneration practices of the financial planning industry. Drawing from academic articles and industry analysts, the Financial Services Royal Commission is likely to have a significant impact on the financial planning industry and the operating model of financial advice firms, which requires the redesign of financial advice business and delivery models. This paper provides some evidence of the changes in the operating model of financial advice firms after the enactment of the Royal Commission's recommendations. We also identify gaps in the literature and highlight some important research issues that provide directions for future research.

Introduction

Over the last two decades, the financial planning industry in Australia has experienced significant changes, ranging from legislative to technological. In 2019, the Financial Services Royal Commission (FSRC) outlined a number of key recommendations which are likely to have significant implications for participants in the financial planning sector. There was an expectation that the FSRC recommendations, in relation to financial advice, would have a major impact on the financial planning industry and advice operating model. However, evidence is still being gathered. In order to examine the impact of the FSRC on the operating model of financial advice firms, we review articles and industry analysis reports related to the impact that the FSRC has had or is likely to have on two key themes: first, financial advice business models, including remuneration models, cost-to-service models and client segmentation. Second, financial advice delivery models including products and platforms, processes and technology, advice distribution channels and customer value propositions.

The change from a predominantly sales-based revenue model to a fee-based advisory model means that the business models of many financial advice firms could be quite different. For example, the advice operating model of big financial advice institutions such as the four major banks, AMP and IOOF Holdings, which have over 9,000 financial advisers operating under a licence they control according to the Australian Securities and Investments Commission (ASIC) (2019), cannot survive after the enactment of the FSRC's recommendations without a substantial change in either pricing to the client or cost efficiencies in the business. However, the change to financial advice business models will have to do more than ensure the provision of advice remains profitable—it will have to adapt to the behaviour of consumers of financial advice and address a new expectation of authentic service models and client relationships. Also, for single or self-licensed advisory businesses it will be vitally important to have a clearly structured client value proposition that demonstrates how that value will add to their clients' financial health compared with non-advice providers.

According to industry analysts (Deloitte Australia 2019), the FSRC would increase the possibility of individual licensing or quasi-licensing—in turn, increasing self-determination and accountability for the individual adviser. These business models could also lead to a shift in both business practice and the support systems of industry. In line with this perspective, we can expect a wide range of competitive service offerings and segmented business models—for instance, the rise of shared services, that will offer a variety of professional services to clients with no product. Also, it is expected that the majority of financial advice businesses post-Royal Commission will intend to offer fee models where fees will generally be a mixture of fixed pricing and hourly rates.

However, after the FSRC, it is evident that the provision of financial planning advice is becoming unviable for many advisers and licensees. A recent report from Adviser Ratings (2020) found that 4,378 licensed financial advisers quit the industry in 2019, equating to a reduction of 15.6 per cent of the total number of financial advisers. This drop is linked to sharp rises in costs, including regulatory, compliance, technology, and professional indemnity insurance. We suggest that the FSRC is likely to have had the greatest impact on smaller financial advice firms which would not have had the necessary infrastructure to implement the Royal Commission's recommendations.

These smaller firms may be more affected by the cash-flow limiting consequences of the cessation of grandfathered commissions effective from 1 January 2021, the reduction of the cap on commissions for life risk insurance products, and anti-hawking rules implemented by mid-2020 to end cross-selling of insurance and superannuation products (Hayne 2019). Therefore, financial advice businesses need to re-evaluate their strategic position and business viability, while focusing their resources on transformational growth.

In light of the ongoing pressures on the operating model of financial advice firms after the FSRC's recommendations, including the segmentation of client bases and the revenue targets, we can conclude that one of the unintended consequences of the FSRC will be that the mass market for financial advice is even less likely to be provided for after the enactment of the Royal Commission's recommendations than was the case before their implementation.

An outline of the article is as follows. Section 2 (Background) gives a broad picture regarding the establishment of the FSRC. It also provides a brief overview of the process followed by the FSRC to identify the systemic causes of problems in the financial advice industry. And finally, presents a summary of the FSRC outcomes and major themes. Section 3 (Studies on the Royal Commission and financial services industry) presents several studies which examine the effects of the FSRC's impact on the financial services industry from different perspectives. Section 4 (The impact of the Royal Commission on financial advice operating models) focuses on providing evidence of the changes in the operating model of financial advice firms after the enactment of the FSRC's recommendations. Section 5 (Future research agenda) outlines suggestions for the future research agenda. Section 6 (Limitations) addresses the study limitations. Section 7 (Conclusion) concludes the paper.

Background

The establishment of the Financial Services Royal Commission

Since 2001, attempts to reform the financial advice industry have been in train to improve the quality of financial advice, strengthen consumer-protection, promote trust and transparency in the financial advice industry and enhance minimum education standards in the sector (Australian Government Treasury 2018). However, progress has not been rapid, and the FSRC, established in 2017, has released ten essential recommendations for the financial advice industry before it can be deemed a profession (Hayne 2019). The recommendations suggest new ways to deliver financial advice, including changes to ongoing fees, disclosure of lack of independence, quality of advice, conflicted remuneration and discipline for misconduct.

Following pressure from whistleblowers, lobby groups and heightened media attention, the FSRC was established in late November 2017 and led by former High Court Judge Kenneth Hayne to investigate misconduct in Australia's banking, superannuation and financial services industry. Some studies suggest that the decision to establish the FSRC was inherently political, more than it was necessary or even desirable (Gilligan 2018; Davis 2019; Singleton &Reveley2020). Nonetheless, the FSRC was charged to investigate the extent to which misconduct fell below community standards and the expectations of financial services entities (Hayne 2019).

A number of studies (Schmulow, Fairweather & Tarrant 2018; Wishart &Wardrop 2018; Coburn 2019; Millhouse 2019; O'Brien 2019) find the establishment of the FSRC contributes to enhancing management accountability with a focus on culture, governance, risk management and remuneration. Also, it helps to improve the performance of regulators such as ASIC and the Australian Prudential Regulation Authority (APRA). However, the implementation of the recommendations will no doubt prove challenging for regulators and financial advice industry players. Also, many of the changes expected would depend upon the outcome of a review by ASIC in 2022.

The Financial Services Royal Commission process

The Royal Commission adopted a case-study approach to present specific cases of misconduct from amongst the over 10,000submissions made to it. The FSRC held seven separate rounds of public hearings from March to November 2018, examining consumer lending practices, financial advice, loans to small and medium enterprises, issues affecting Australians who live in remote and regional communities, superannuation, Australia's insurance industry and policy questions in order to highlight structural and systemic issues relating to misconduct within the financial services sector. An interim report was published on 28 September 2018 (Hayne2019).

According to Gilligan (2018), a significant element in the success of the FSRC's process to cast light on the misbehaviour in Australia's financial sector and develop high levels of public interest was the coercive powers available to royal commissions of inquiry in Australia. The FSRC was able to call witnesses to give testimony, seize documents and hold secret hearings to protect whistleblowers (*Royal Commission Act 1902*, s. 2).

On the other hand, Davis (2019) identifies a number of shortcomings in the FSRC 'case study' process including, firstly, that its focus on specific types of misbehaviour limits the FSRC's ability to deal with other types of misbehaviour. Second, a focus on only the poor outcomes of the financial system may lead to a disregard of its desirable outcomes. Third, the search for solutions lies primarily in examining behaviour of one side of the participants in financial contracts. Finally, assessing whether the undesired behaviour observed is an Australian problem or one commonly found in most financial systems—and suggesting some fundamental problems warranting rectification—is ultimately beyond the scope of the FSRC.

The Financial Services Royal Commission outcome

On 4 February 2019, the Government publicly released the final report of the FSRC which outlines 76 recommendations to avoid recurring misconduct in the financial services sector. The themes of the FSRC's report are concentrated around culture, governance, management accountability, conduct, remuneration and the performance of regulators (Hayne 2019). The final report calls for deep changes in corporate cultural practices which have implications for the board and governance arrangements. Also, the final report calls for fundamental changes in law enforcement cultural practices which have implications for the conduct regulator (ASIC) and the corporate sector in Australia (Hayne 2019). The Commissioner Kenneth Hayne said 'culture, governance and remuneration march together'. This means that the reform of organisational culture and governance in financial services will impact how remuneration is designed, implemented, and monitored.

The FSRC final report sets out six principles to achieve good governance and appropriate culture within the financial services industry. The six norms of conduct include that all financial services entities should obey the law, not mislead or deceive, act fairly, provide services and/or ensure products are fit for purpose, deliver services with reasonable care and skill, and act in the best interests of their clients.

It is arguable that the soft-law guidelines approach recommended by Commissioner Hayne as a tool to develop good corporate culture has the potential to prevent future systemic misconduct in the financial services sector. However, as Smith (2012) points out, compliance with soft regulation is voluntary and, unlike hard law, there are no legal sanctions upon breach. Davis (2019) also questions the ability of the soft-law guidelines approach recommended by Commissioner Hayne to prevent non-compliance in the financial services sector, considering that self-regulation by industry and professional associations failed to prevent misconduct and poor behaviour in the first place. Similarly, Hargovan (2019) suggests that the reliance on soft law to develop good corporate culture may be short-lived. In contrast, Marsh and Phillips (2019) agree that the cultural concerns are better tackled through the judicial system than the legislature. Those authors suggest that the soft-law guidelines approach recommended by the FSRC seems intent on limiting the creation of new laws and regulations and is capable of preventing misconduct in the financial services sector more successfully than, for example, the United States' financial crisis responses.

Studies on the Royal Commission and financial services industry

The existing literature reveals a dearth of research on the FSRC and its impact on financial planning advice, particularly about the changes in operating models of financial advice firms, including business and delivery models, after the enactment of the FSRC's recommendations.

Since the establishment of the FSRC in 2017, most available studies discuss the FSRC's regulatory framework and its implications for the conduct regulator and the corporate sector in Australia. Schmulow, Fairweather and Tarrant (2018) conclude that the establishment of an Assessment Board in Australia to provide continuous oversight of the financial regulators—APRA and ASIC—would enhance accountability and assist improvements in the regulators' culture, ensure prevention of regulatory capture while also serving as an effective addition to the current Australian 'twin peaks' financial regulatory architecture comprising APRA and ASIC. Wishart and Wardrop (2018) argue that the FSRC will create further regulatory and compliance pressures while possibly offering enhanced accountability within financial service entities; however, they state that it is highly unlikely that the FSRC's outcome will be sufficient to reform the corporate culture within the financial services industry due to the industry's privacy, autonomy, and competition concerns. Hanrahan (2019) examines the twin peaks financial supervisory architecture which is recommended by the FSRC—comprising a prudential regulator and a market conduct regulator. Hanrahan (2019) goes on to suggest a 'three peaks' model to strengthen the regulation by establishing a specialist regulatory agency with responsibility for consumer protection in the retail market for financial products and services. Sy (2019) provides detailed explanations for the observed failure of the regulators to enforce the law. That author shows that Australian financial markets are evidently not competitive markets as they are dominated by monopolies and oligopolies, and the failures are due to government sanctioned oligopolies which have captured the regulators. Lumsden (2019) explores the implications of the FSRC for corporate Australia, agreeing with Commissioner Hayne that the community expects corporate Australia to foster a culture that promotes good leadership, decision-making and ethical behaviour. Millhouse (2019) introduces a framework for the re-integration of the intent and spirit of the law with its statutory manifestations, supporting the FSRC's long-run reform objectives. Gilligan (2019) discusses the effects of the FSRC as a mechanism of official discourse, and concludes that the FSRC has been an influential inquiry with lasting ramifications for the Australian financial services sector. However, that author raises questions about its truly transformative effects in areas such as delivering accountable regulation for improved consumer protection and competition.

Other studies examine the FSRC's regulatory framework and findings from an international context. For example, Marsh and Phillips (2019) consider that the various forms of misconduct in the financial services sector are not an Australia-only problem. Those authors expect that the FSRC's approach will be more successful in preventing misconduct in the financial services sector than the United States' financial crisis responses. D'Hulster (2019) analyses and compares the findings of the FSRC and the International Monetary Fund's (IMF) Financial Sector Assessment Program (FSAP) assessment of Australia, finding that the legal approach of the FSRC has proven well-suited for identifying violations of laws, regulations, and norms. But it is less well-suited for making recommendations in a complex, globally benchmarked and continuously evolving area as the financial sector. Coburn (2019) concludes that the FSRC report will have a global impact where organisations and regulators internationally will be able to learn compliance and risk lessons from the outcomes of FSRC. And this will lead to a new mandate for compliance and risk teams within organisations to be more effective and call out misconduct earlier. Singleton and Reveley (2020) compare the Australian financial sector misconduct with major British and American banks. That study concludes that the Hayne Royal Commission exaggerates the level of misconduct within the Australian financial sector when viewed from an international perspective. That study further suggests that the FSRC's findings unintentionally provide support for the populist view that Australian financial institutions are exceptionally unethical in their treatment of customers and clients.

There are a number of studies examining whether the FSRC has the ability to make a positive cultural change in the financial advice industry and reduce future misconduct. According to Davis (2019), due to the FSRC's limited mandate and limited time frame, its recommendations are unlikely to provide a lasting solution to concerns about the culture within financial services and the resultant misconduct. Davis (2019) argues that the FSRC has made a small step towards reducing financial sector misconduct; however, it has done nothing to remove the naked greed and the pursuit of profit at the expense of reputation which can generate incentives for misconduct. Therefore, in the absence of recommendations for significant structural changes to ultimately drive behaviour, that author concludes that FSRC is likely to be a temporary fix for preventing financial sector misconduct. In line with this perspective, Turnbull (2019) investigates the causes and solutions for misconduct in the financial services industry and concludes that a new governance model is needed that introduces stakeholders as co-regulators to provide continuous comprehensive identification of misconduct, leading to an amplification of regulation and a reduction in the role, size, cost, and interventions of regulatory agencies.

The impact of the Royal Commission on financial advice operating models

Industry analysts are raising concerns that the FSRC's recommendations will have serious implications for the revenue models of financial advice firms and may in turn decrease consumer access to financial advice. The removal of grandfathering and conflicted commissions (Hayne2019) would force many advice practices to restructure their entire business models. Revenue and cost pressures will most likely demand financial advisers to increase their up-front fees, making the initial cost of advice more expensive.

An analysis report by Deloitte Australia (2019) indicates that everything in the financial advice industry would change as a consequence of the FSRC, including advice quality, compliance and regulation, products and services, business models, the role and obligations of the adviser and the size of the industry. The report suggests that the FSRC's outcomes will reshape the business models for many in the financial advice community and would likely lead to a wholesale exit of practices and practitioners. Another analysis report issued by KPMG Australia (2019) on key implications of the FSRC, emphasises that there is a need to focus on providing quality advice for clients while also ensuring advice businesses remain profitable. The report identifies three levers that directly impact the delivery of quality financial advice in a compliant and efficient manner: first, efficiency in the implementation of advice. Second, sustainable financial planning practices with sufficiently robust revenue streams. Third, provision of the right-sized advice for the client's needs and profile.

In this section, we provide some evidence that shows the changes in the operating business and delivery models of financial advice firms after the FSRC's recommendations and the effect on consumer outcomes.

The changing nature of the financial advice revenue model

According to industry analysts (Adviser Ratings 2019; Deloitte Australia 2019; KPMG Australia 2019) the FSRC's recommendations will have a negative impact on the sustainability of financial advice practices. Material impacts on revenue models at both a practice/firm level and a licensee level would arise from the cessation of grandfathered commissions effective from 1 January 2021 (Hayne 2019, pp. 185–188), reduction of the cap on commissions for life risk insurance products (Hayne 2019, pp. 189–190) and anti-hawking rules implemented by mid-2020 to end cross-selling of insurance and superannuation products (Hayne 2019, pp. 29–31). This is likely to impact on practices across the financial advice industry, leading to depressed valuations and significant effects on practice profitability and solvency. The industry analysts suggest that financial advisers who rely on passive income are required to change the way they are paid for their services by transitioning from conflicted remuneration to more transparent, flexible, and non-conflicted revenue models such as fee-for-service. In line with this perspective, Financial Planning Association (FPA) CEO Dante De Gori (2019) argues that the shift from a sales-based revenue model (i.e. grandfathered commission) to an advice-based revenue model (i.e. fee-for-service) would have an initial negative impact on the value of financial advice businesses in terms of return, profit, and cash flow. However, it is important for advice providers to replace the lost revenue and grow in a post-FSRC reform environment.

In a transaction showing the magnitude of the challenges confronting financial advice businesses after the FSRC, CountPlus acquired Count Financial from the Commonwealth Bank of Australia for $2.5 million including 359 advisers and 160 firms with $8.1 billion of funds under administration, according to a statement on the ASX (2019). A document prepared by CountPlus for an extraordinary general meeting to ratify its acquisition of Count Financial revealed a potential 60 per cent revenue decrease due to regulatory changes, including the Future of Financial Advice (FoFA) reforms and the FSRC. 'There is accordingly a risk that the loss of the licensee advice fees, and grandfathered commissions will have a material impact on Count's revenue, and therefore profitability', the document said. The CountPlus document has also called for a new revenue model towards fee-for-service due to changes in revenue: 'There is a revenue risk to Count from these proposed changes and a need for Count's business to transition towards fee-for-service and/or other permissible revenue models.'

Further pressures on financial advice cost-to-service models

The FSRC's recommendations have forced many financial advice practices to increase the cost of advice, at both a practice firm level and licensee level. The increase in advice costs reflected an increase in administration costs associated with changes to ongoing fee arrangements which have forced advisers to add opt-in costs for ongoing services, ranging between $100 to $250 per client, or around 12 per cent, according to surveys conducted by the FPA (2020). Also, the reasons include higher compliance costs associated with a new disciplinary system for financial advisers and a mandatory reporting of compliance concerns.

According to a benchmarking study issued by Adviser Ratings (2020) which included responses from around 1,500 advisers, the median cost of advice had increased to $3,256 in 2020. This was up by 16 per cent from the median cost of advice of $2,800 in 2019, and up more than 29 per cent from the median cost of advice of $2,510 in 2018. The reasons include higher advice operating costs and lower supply of advisers.

Analysts at KPMG Australia (2019) suggest providing the right-sized advice for the customer's needs instead of traditional comprehensive advice, including direct distribution to the customers through efficient, transparent, and simple advice platforms with enhanced technology solutions, creating an efficient cost-to-service model to reduce the cost of advice for better customer outcomes and improved profitability.

The structural change in the vertical integration model

There is no recommendation in the FSRC's report mandating the structural separation between offering products and providing advice, as the benefits of requiring separation would outweigh the costs (Hayne2019, p. 196). However, the absence of a specific recommendation mandating change does not mean the structure of the vertical integration model will operate the same as before. The FSRC's report includes a number of recommendations primarily aimed at eliminating conflicts of interest (Hayne 2019, pp. 26–27), which will impact the profitability of vertically integrated businesses by increasing costs. This will likely result in speeding up the transition away from vertical integration in the industry, even in the absence of forced structural separation, according to Commissioner Hayne (Hayne 2019, pp. 190–196).

As a result of the FSRC, the Government passed legislation to improve consumer protection in relation to financial and credit products. The updated Design and Distribution Obligations (DDO)[1] and Product Intervention Powers (PIP)[2] will further improve consumer outcomes by requiring financial product manufacturers and their distribution channels to ensure products are only sold to customers for whom they are likely to be suitable. However, the responsibility lies with the financial adviser to ensure all conflicts are removed. Under the product intervention power, ASIC has the ability to request necessary information and to ban financial products when there is a risk of significant consumer detriment (Deloitte Australia 2019).

The growing increase in the adoption of digital operating models

In light of the ongoing pressures from the FSRC's recommendations to bring about tangible change in the way independent advisers operate, there is an overwhelming need for advice practices to deliver services through efficient, transparent and simple advice platforms using improved technology solutions. According to Financial Planning Association CEO Dante De Gori (2020), the adoption of enhanced technology solutions by financial advice businesses will play a critical role in promoting standardisation and process improvements, improving compliance, and increasing efficiency to ensure the provision of advice remains profitable. This would reduce administrative staff time, in turn lowering cost, reducing human error, and increasing the efficiency of managing models. In addition, this would allow broader service offerings and lead to increased revenue and profitability of financial advice entities.

Technology will have an important role to play in the financial planning industry, especially with the exit of large institutions after the findings of the FSRC and post coronavirus 2019 (COVID-19). A KPMG Australia (2020) survey of over 1,500 people finds consumers of insurance, super and financial advice products have withdrawn increasingly during COVID-19 while also seeking better value. In line with this perspective, studies by Adviser Ratings (2018; 2020) suggest that digital financial planning advice (Robo-Advice)—expected to grow 43 per cent per annum in the next five years—can fill this gap and should complement the traditional advice industry by improving the accessibility and affordability of advice for consumers.

The changes in customer value proposition of advice firms

The FSRC has encouraged advisers to build meaningful relationships with clients through the adoption of a 'customer first' duty to enhance their value proposition (Hayne 2019, p. 120). For example, the requirement for financial advisers to seek annual renewal, in writing, of ongoing fee arrangements instead of every two years (Hayne 2019, p. 25) would provide customers with more meaningful value than would an automatic fee deduction from their investment funds. Also, this will give customers greater visibility of the ongoing advice fees they are paying to financial advisers against the value they receive. And this will help financial advisers to engage with clients and to better understand their needs.

[1] Refer to regulatory guide 274: Product design and distribution obligations (ASIC December 2020).

[2] Refer to regulatory guide 272: Product intervention power (ASIC June 2020).

An industry analysis report by Deloitte Australia (2019) suggests some changes to the value proposition for advisers and licensees to attract a broader spectrum of customers after the FSRC. Advisers and licensees will need to focus on three areas, including education, research, and investing in technology to make it easier to interact with customers in a cost-efficient way. In addition, the value propositions need to help advisers to engage with clients and understand their capacity and needs.

However, keeping clients better informed and valued would increase the operating cost of advice and price out lower income customers from accessing advice services. According to an Adviser Ratings (2020) study which included around 1,500 advisers, there are multiple variables behind increasing the costs of advice following the FSRC. One of the reasons is because financial advisers are getting better at understanding their customer value proposition and charging appropriately.

Growing the advice gap in Australia

Industry analysts at CPA Australia (2020) are raising concerns about the reduction in the supply of financial advice and its effect on the availability and affordability of advice as consumer needs increase. The annual report published by ASIC (2020) shows a reduction in the supply of financial advice to Australian consumers. The report notes as of 25 June 2020, the number of financial advisers is 11% below the long-term average prior to 1 January 2019. This exit of advisers from the industry is driven by a number of factors not excluding the Financial Adviser Standards and Ethics Authority (FASEA) regime. According to Adviser Ratings (2020), 4,378 advisers quit the industry in 2019, equating to a reduction of 15.6% of the total number of financial advisers.

An advice gap is created when consumer demand for financial advice continues growing, but advice capacity reduces as advisers quit the industry. As a result, the cost of delivering advice will be higher than customers are prepared to pay. In light of this, ASIC (2020) released a consultation paper on promoting access to affordable and limited advice for consumers, especially low worth customers, as part of its “unmet advice needs project”.

Future research agenda

Future research can be conducted to empirically investigate the impact of the FSRC’s recommendations on the operating model of financial advice firms by collecting the data from a sample of small, medium, and large Australian financial services (AFS) licensees that are authorised to provide personal advice to retail clients.

In addition, there are several avenues for further research—for example, a study about the effect of the FSRC on the uptake of digital advice. Digital financial advice might be the only low margin, mass market model that will survive in the long term. Or further, a study examining the extent of the changes in financial advice pricing models after the enactment of the FSRC’s recommendations, and whether competition in financial advice provision prevents excessive pricing.

Limitations

This study has limitations normally associated with qualitative research, which are limited validity and verifiability, and the reliance on researcher interpretation. Also, this study only explores the impact of the FSRC on certain areas of the operating model of financial advice firms. Future research can be done to investigate the effects of the FSRC on other areas of the financial advice operating model, such as on financial advice marketing approaches, and people and change management. Notwithstanding its limitations, this research contributes to new aspects of financial planning advice. Studying the impact of the FSRC on the operating model of financial advice firms is a unique contribution to the existing research.

Conclusion

Commissioner Hayne outlined a number of recommendations in relation to financial advice (Hayne 2019, pp. 25–28) primarily aimed at improving the quality of financial advice, strengthening consumer protection and promoting trust and confidence in the financial planning industry. However, many of the changes would depend upon the outcome of a review by ASIC before the end of 2022.

This paper provides some evidence of the impact of the FSRC's recommendations on the operating model of financial advice firms and their effect on consumer outcomes. The recommended cessation of grandfathered and conflicted commissions has triggered a rethink of the value chain of advice and service, transitioning towards more transparent, flexible, and non-conflicted revenue models such as fee-for-service to cover costs and ensure that the provision of advice remains profitable. The shift towards more transparent and flexible fee models such as fee-for-service would provide more meaningful value to customers, but there will be some negative impacts in the short to medium term. Increasing the cost of advice means that lower income earners will no longer be able to afford or justify the cost of financial advice.

Also, the recommendations of the FSRC are likely to accelerate the adoption of digital operating models including robo-advice and digital delivery to mass customers. Implementing enhanced technology solutions will play a critical role in delivering the required improvements effectively and efficiently. A digital advice operating model will enable advisers to meet compliance and regulatory obligations more easily, to reach new and more diverse customers living in different geographical locations faster, and to significantly reduce the operating cost of advice provision.

This paper finds the change in the vertical integrated model would lead product manufacturers and advisory dealer groups to review their distribution strategy, pricing, and structure. The increase in dealer group fees by as much as 30 per cent, according to Association of Financial Advisers (2019), to cover off both increased costs and the loss of revenue from some of the recommendations of the FSRC (Hayne 2019, pp. 25–28), will affect the cost of advice, making the economics of financial advice firms more challenging. On the other hand, the decline of the vertically integrated model will encourage product and platform competitiveness based on offering rather than fee.

Regarding the customer value proposition, financial advice practices will have to focus on a number of areas over and above compliance, including technology, education and research. A well-defined customer value proposition that helps the adviser to engage with clients and to better understand their needs and capacity to pay is important to both attract and retain customers. Therefore, financial advice practices that cannot prove their value proposition post-FSRC will struggle.

One of the major recommendations of the FSRC's report in relation to financial advice is the new education requirements for financial advisers (Hayne 2019, pp. 28). The application of the new FASEA code of ethics has attempted to improve standards by raising the education of financial advisers. However, the current approach has led to a reduction in the number of financial advisers according to ASIC (2020). The growing mismatch between supply and demand in the advice industry is increasing the cost-to-service models and lowering the level of advice being delivered to customers. Therefore, ASIC nominated Australia's unmet advice needs as one of the new financial advice focal points in its 2019–2023 corporate plan[3]. The purpose is to examine the gap between the demand and supply of advice and to seek potential solutions to reducing this gap.

In summary, the FSRC's recommendations represent both a challenge and an opportunity for financial advice firms to review their current operating models and identify opportunities to digest and consider how to implement the recommendations into their existing models for better customer outcomes and improved profitability.

[3] Refer to ASIC Corporate Plan 2019–23, page 20.

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