

2017 State of digital advice transformation

A guide to RG 255: Building an effective, compliant digital advice solution

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Unpacking RG 255 and the digital advice opportunity



Advice scandals have plagued the financial services and superannuation industry for decades, causing irrefutable brand, reputation and financial damage, but they could be a thing of the past.

Digital advice technology, if properly designed and implemented, has the potential to eliminate advice failures by facilitating and monitoring the delivery of effective and compliant advice, leading to improved client outcomes.

Coupled with a traditional human adviser to provide validation and coaching, when required, it's an unbeatable, scalable combination that's able to restore consumer confidence in the financial service industry and lift demand for advice.

Recently the Australian Securities and Investments Commission (ASIC) released its guidance on providing digital financial product advice for retail investors (RG 255).

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RG 255 examines key areas that organisations offering digital advice, or considering

offering digital advice, need to consider such as monitoring and testing algorithms; filtering out unsuitable customers; regularly reviewing advice; and logging all activity.

This white paper - the first in a series that explores the digital advice opportunity in Australia - unpacks RG 255 and the digital advice opportunity.

What's ASIC up to?

In ASIC's Corporate Plan for 2016-17 to 2019-20, the regulator listed digital disruption, new business models and "complexity in financial markets and products, driven by innovation" as major long-term challenges and opportunities.

It cited heightened surveillance and fostering a "gatekeeper culture" in financial services and managing risks from digital disruption as key areas of focus in 2016/17.

"We will focus on managing the risks from structural change and disruption in financial markets and services arising from the rapid pace of technological developments. This includes new products and service delivery models that, if poorly implemented and operated, can undermine market integrity and trust and confidence," the report stated.

However, ASIC also acknowledged that technological innovation had the potential to improve efficiency and be a “powerful force for competition, driving the development of products that better meet consumer needs and improve customer access”.

Digital advice is unquestionably a new advice model that can give more Australians affordable access to quality advice.

But the strength of leading digital advice solutions won't be cool algorithms or beautiful front-ends, although they're important. On that point, even the most creative front-ends and clever algorithms will be useless if they're not compliant.

There's room for both digital and human advisers and increasingly a hybrid omni-channel model that combines the two.

The strength of leading digital advice solutions will be the complementary relationship they have with human advisers to ensure clients' needs are seamlessly met.

As the advice industry progresses further along the digital path, there's a realisation that it doesn't have to be one or the other.

There are complex situations beyond the scope of digital advice.

There are low-value clients that human advisers can't service economically.

There's room for both digital and human advice, and increasingly a hybrid (“omni-channel”) model that combines the two.

Our research reveals that ordinary Australians are unlikely to support a purely automated, online solution unless they know that there are capable, qualified people behind it monitoring the advice they receive and ready to proactively step in when needed.

RG 255 demonstrates that ASIC wants that too.

Using the airline business as an analogy, there's a reason why millions of travellers pay more to fly with top airlines over budget carriers.

Both have automated systems for finding and booking flights and checking in, and 90 per cent of the time people will transact and fly without a glitch but many travellers will happily pay more for the peace of mind knowing that they can pick up the phone at any point and speak to a trained, experienced person if they're stuck.

How much more important is it for financial institutions dealing with peoples' life savings, insurance needs and retirement dreams, to give their customers that certainty and confidence.

What you need to know

Key features of compliant digital advice

One of the first and most important parts of developing a compliant, sustainable digital advice solution is to clearly define the scope and limitations of the proposition.

ASIC spends considerable time describing exactly what a compliant digital advice solution should look like in Section D of RG 255.

Section A provides a summary of the state of digital advice in Australia, Section B clarifies the licensing obligations, Section C details the general obligations applying to digital advice and Section D, titled “Providing scaled advice in the best interests of the client”, examines the need for digital advice providers to define the nature and scope of their advice, and clearly explain what advice they don’t offer.

Digital advice providers must also have a “triage” or filtering process to determine who is and who isn’t suitable for digital advice.

Establishing an effective triage system to assess customers’ needs

Under RG 255, digital advice providers must have a system for performing the following tasks.

- 1) **Qualifying customers upfront (RG 255.101-104)**
- 2) **In-journey validation (RG 255.105-109)**
- 3) **Ongoing monitoring and testing of advice and algorithms (RG 255.110-117)**
- 4) **Logging, storing and retrieving data (RG 255.115-117)**

Upfront client qualification (RG 255.101-104)

RG 255.101: “Digital advice providers offering scaled advice should ensure that they have a robust ‘triage’ or filtering process in place to filter out clients for whom the digital advice is not appropriate”.

It’s critical for digital advice providers to know when to give advice and when to hand over to a human.

Successful traditional advisers limit the scope of their advice and can quickly, unemotionally identify who they can and can’t help.

Whatever the reason, whether it's because their needs are too complex or too basic to service economically, traditional advisers pick and choose their clients. Those they can't help, or don't want to help, they may refer elsewhere.

Similarly, if it's deemed that a client needs help and guidance beyond the scope of digital advice, they must be stopped from going any further.

Where this occurs, customers should ideally be given an explanation and referred to someone who can help them. That may be a traditional adviser or a qualified call centre specialist. Call centres will increasingly be full of staff that are RG 146 qualified and possess skills that are somewhere between a paraplanner and senior financial planner.

As organisations adopt technology to mine their customer accounts and gather insights, increasingly members or customers will be triaged proactively to suitable channels.

In-journey validation (RG 255.105-109)

RG 255.105: "If a client provides inconsistent answers in relation to their relevant circumstances, a digital advice provider will:

- *Identify the inconsistencies and provide the client with additional information and an opportunity to change their input;*
- *Contact the client to clarify their inconsistent responses;*
- or*
- *Filter the client out of the model.*

As a customer progresses through the advice process, digital advice providers need to have systems and rules in place to recognise abnormal or inconsistent responses.

For example, if half-way through a questionnaire or during the advice journey, a client contradicts information previously supplied, a digital advice provider must be able to instantly pick up on that and give the client an opportunity to clarify their position before either progressing them or filtering them out of the process.

Digital advice providers must also be able to discern if a client's responses and behaviour makes sense.

For example, if a 60 year old widow nearing retirement wants to invest the majority of her super in a high growth fund, there must be systems in place to recognise that that is not an appropriate strategy under the circumstances and prevent the client from proceeding.

But this is just the first stage of what digital can offer.

Rather than simply preventing people from receiving poor advice, digital platforms will soon be dynamically capturing and generating 'big data'. Digital won't just make recommendations based on user inputs and algorithms but will combine that with intelligence garnered from 'big data' to further optimise advice recommendations.

This is the challenge for the majority of digital solutions.

Ongoing monitoring and testing of advice and algorithms (RG 255.110-114)

RG 255:110: "We expect digital advice licensees to have robust compliance arrangements in place to regularly monitor and test the quality of digital advice provided to clients. This means that a sample of the digital advice provided should be reviewed by a suitably qualified individual for compliance with the law."

This section reveals that ASIC's view of an effective, credible and viable digital advice solution is one that combines technology and human judgement to ensure investors receive quality, compliant service and advice.

RG 255.110 is consistent with ASIC's requirements on AFS licensees providing traditional financial product advice.

ASIC's draft version of RG 255 may not have addressed the interdependent relationship between digital advice and traditional advice but the regulator rectified that in its final guidance which found that what's available to consumers is broader than either digital or traditional advice alone. Consumers can opt for a combination of both.

An unintended outcome of the current digital advice debate is that it has highlighted the strengths of traditional advice.

Our research indicates that investors crave validation. They want to know that they're on the right track. But early 'robo-advice' solutions, which were largely focused on gathering funds under management (FUM), didn't facilitate that.

In RG 255.111, ASIC is clear that digital advice shouldn't be a "tick-a-box" or set-and-forget exercise. Rather "file reviewers" should actively assess all the information and use their judgement to form a view on the quality of advice provided.

RG 255 states: "Frequent reviews of digital advice should be conducted initially, and with heightened scrutiny when any change to an algorithm is made".

ASIC goes a step further to suggest that digital advice providers consider conducting their own shadow shopper exercises to randomly test and review the advice being provided.

Logging, storing and retrieving data (RG 255.115-117)

RG 255.115: "Digital advice licensees are responsible for advice that does not comply with the law and should have procedures in place to identify and contact clients who have been provided with inappropriate advice".

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Digital advice providers must be able to account for who did what, when and why in a timely manner, which requires them to have a powerful and secure system for automatically logging and storing every client response, activity and exchange. The system must be able to record the version of the algorithm used to deliver advice and the content on each screen seen by the client.

This requirement is infinitely stricter than the rules that apply to traditional advisers.

Under the Corporations Act, licensees and advisers are only required to keep "adequate records about their business", including copies of Statements of Advice (SoAs) and Records of Advice (RoAs). That's a much less onerous task and even then, many organisations would struggle to present SoA and RoA files for the last 12 months if requested by ASIC.

This rule is controversial because there's the potential for the lines to blur when a traditional adviser uses technology to automate seemingly trivial jobs such as updating a client's personal details, changing

bank account details, issuing risk profiling questionnaires, booking meetings and chasing up approvals.

Traditional advisers may use traditional financial planning software like XPlan or Coin to note their actions and store manually-edited advice documentation but there's no formal requirement for them to do so.

Furthermore, the lax rules provide no guarantee that the

conversations and activities recorded are an accurate representation of what actually happened or that what's listed hasn't been edited or tampered with.

On the other hand, RG 255 requires digital advice providers to extensively log all activity, distinguishing between advice delivered digitally and advice delivered by a person. If a person is involved, it should be clear exactly who did what.

ASIC's great expectations

- Define and explain the scope of advice
- Get clients to actively demonstrate that the advice they need is within that scope
- In a timely manner, inform clients about the limitations and potential consequences of the scope of advice
- In a timely manner, inform clients about the risks and advantages of the advice being provided
- Filter out unsuitable clients
- Clearly disclose and explain all upfront and ongoing fees before the advice is given or implemented
- Inform clients about how they can withdraw from the advice being provided before the advice is implemented
- Explain the dispute resolution options and processes available
- Explain why the client is likely to be in a better position if they follow the advice

The advice transformation

Who will be the winners and the losers?

Institutions are only just beginning to understand the enormous digital advice opportunity and the powerful controls that can be established to protect investors and themselves.

In the years following the government's December 2013 decision to introduce changes to the Future of Financial Advice legislation designed to reduce compliance costs and ease the regulatory burden on the financial services sector by facilitating the delivery of scaled advice solutions, the banks and institutions started developing scaled, or limited, advice solutions to deliver advice en masse.

They could see the potential for scaled advice to help them reach more people, tap previously disengaged customers, expand their distribution footprint and grow FUM.

But after a number of failed attempts to build proprietary solutions, millions of dollars spent on high profile enforceable undertakings, there's a realisation that developing and maintaining an effective and compliant scaled solution is hard. At any one time, a dealer head or advice executive is only really

across a small percentage of the advice that the organisation is giving.

Another fundamental challenge for institutions is defining the scope and parameters of their limited advice offering and managing conflicts.

For example, a scaled advice proposition backed by a life insurance company will be geared to sell insurance so how do they deal cost-effectively with a customer who wants to reduce debt and start a savings and investment plan?

Similarly, how does a retail bank with literally millions of bank customers offer cost effective and compliant personal scaled advice about a customer's super or insurance?

And finally, how does a super fund, that only offers an account based pension and annuities, offer a personal advice proposition to all members when caps might require additional products to be considered? Currently funds have no choice but to hand those members over to a traditional adviser in a 3rd party dealer group.

Digital advice aims to overcome such limitations by creating algorithms to generate objective personalised information and advice. Furthermore, regardless of the system's results, customers can request to speak to a person for validation.

Validate me

While RG 255 is a guideline, it is already recognised as the bible for digital advice players.

It has provided the risk and compliance staff and senior executives within large organisations with a blueprint for developing their digital advice solution.

They are just beginning to understand the digital advice opportunity and the powerful controls that can be established to protect investors as well as themselves and other stakeholders.

RG 255 is important for many reasons but primarily because it has the potential if implemented properly, to prevent a digital advice scandal from occurring.

In the last few years, a plethora of unremarkable 'robo-advice' solutions have sprung up, many primarily focused on asset gathering. The industry's concern, which prompted ASIC to devise RG 255, is the threat of a digital advice failure given how easy it is to build a professional-looking website, develop a couple of calculators and algorithms to spit out a SoA and push investors into products tied to the software provider.

The potential fallout is infinitely greater with digital advice because there's no real limit to the number of customers a digital solution can service in a short period of time.

Within hours, digital advice could be disseminated to hundreds of customers. Traditional advice on the other hand is limited to an adviser's capacity speak to clients face-to-face or over the phone.

According to Macquarie Financial Planning Benchmarking Report (2014), the average Australian adviser services around 115 clients.

RG 255 is important because it gives digital advice providers direction and guidance but it also gives ASIC a benchmark and standard to evaluate them. Without rules and guidelines, ASIC can't be an effective regulator.

From a consumer perspective, knowing there are checks and balances in place designed to protect them against poor or inappropriate advice and rogue operators builds confidence.

That confidence will ultimately stir more Australians to seek advice.

At no other time in financial services history has ASIC been able to release guidance on the provision of advice without intense lobbying from industry players without vested interests.

There's no question that RG 255 is a unique document. It marks an inflection point in rebuilding confidence in financial advice for investors and financial institutions and ultimately for the national good.



If you'd like to find out more about digital advice technology or start a conversation with Decimal today, please contact jk@decimal.com



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