



The “Two Sentences” Test

Can the Client Explain the Tax Outcome Back to You

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Abstract

The Two Sentences Test provides a simple but powerful framework for assessing whether true client understanding has been achieved in financial advice. Rather than relying on technical explanations or disclosure documents, the test asks a single question: can the client clearly explain the outcome of the strategy back to the adviser in plain language?

In an environment of increasing complexity, regulatory scrutiny and ethical expectations, this approach shifts the focus from what advisers say to what clients understand and can articulate. By embedding this test into advice conversations (particularly before implementation) advisers strengthen informed consent, improve client outcomes, and enhance regulatory defensibility.

The article argues that the discipline of slowing down, testing comprehension, and documenting client understanding is not merely best practice, but a core professional obligation. Ultimately, the Two Sentences Test reinforces that quality advice is measured not by speed or technical completeness, but by the client's ability to understand and confidently explain the decisions they are making.

Learning Outcomes

After reading this article, advisers should be able to:

1. Understand why disclosure does not equal understanding
2. Recognise the ethical importance of testing client comprehension, not assuming it
3. Identify why tax advice is especially prone to misunderstanding
4. Apply the Two Sentences Test to confirm informed consent
5. Detect gaps in client understanding before advice is implemented
6. Strengthen ethical practice by prioritising clarity over speed
7. Improve advice defensibility through better documentation of understanding

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Through ongoing engagement with financial advisers and licensees, KeyInvest continues to invest in its digital platform and adviser portal delivering streamlined application processing, enhanced client visibility and efficient administration to support advisers in recommending investment bond solutions that empower Australians to achieve their goals with confidence and clarity.

About the Author

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Introduction

Financial advice has never been more complex. Tax law, superannuation rules, estate planning structures and investment products have evolved into a dense web of interdependent decisions. Advisers invest significant time ensuring technical accuracy, modelling outcomes, and complying with extensive disclosure obligations. Yet despite this effort, one ethical question remains decisive:

Does the client actually understand what will happen if they follow the advice?

If the answer is no, informed consent has not occurred, regardless of how comprehensive the Statement of Advice may be. The Financial Planners and Advisers Code of Ethics 2019 requires advisers to act only with a client's free, prior and informed consent (FASEA, 2019). ASIC guidance similarly emphasises that disclosure alone is insufficient if it does not result in genuine understanding by the client (ASIC, 2024).

This distinction is critical. Many advice failures do not arise because the advice was technically wrong, but because the client did not understand the consequences until after the outcome had occurred. Complaints, disputes and remediation often follow not from poor intent, but from poor comprehension.

This article introduces the **"Two Sentences Test"** a simple but powerful ethical tool and explores why the ability of a client to explain a tax outcome back to their adviser is central to professional, defensible and ethical advice.

Disclosure is not understanding

The regulatory framework governing financial advice places significant emphasis on disclosure. Financial Services Guides, Statements of Advice and Product Disclosure Statements are designed to provide clients with information about services, risks, costs and consequences. These documents are necessary, but they are not sufficient.

ASIC has repeatedly acknowledged the gap between information provided and information understood. Good quality advice requires advisers to take reasonable steps to ensure clients are likely to understand the advice and be in a better position if they follow it (ASIC, 2024). Simply delivering documents (no matter how detailed) does not satisfy this requirement.

The Code of Ethics reinforces this distinction. Standard 4 requires advisers to have reasonable grounds to be satisfied that the client understands the advice and consents to it (FASEA, 2019). This obligation goes beyond procedural compliance. It requires active engagement with the client's comprehension.

In practice, many advisers equate client signatures, nodding, or silence with understanding. Ethically, these indicators are unreliable.

Why clients overestimate their understanding

Behavioural research explains why advisers cannot rely on apparent agreement as evidence of comprehension. Daniel Kahneman's work on cognitive bias demonstrates that people routinely overestimate how well they understand complex information, particularly when it is presented by an authority figure or expert (Kahneman, 2011).

Several cognitive biases are particularly relevant in advice interactions:

- **Authority bias:** clients defer to professional expertise rather than challenge explanations
- **Cognitive overload:** complex advice exceeds working memory capacity
- **Framing effects:** outcomes are perceived differently depending on how they are described

Tax advice is especially vulnerable to these effects. Clients may hear “tax saving”, “concessional”, or “efficient” and assume that downsides are minimal or irrelevant. They may believe they understand the strategy because they trust the adviser, not because they have processed the implications.

As a result, clients may genuinely believe they understand a tax strategy, until its consequences materialise months or years later.

The ethical standard: informed consent

Informed consent is not a passive state. It is an active process that requires:

- clear explanation
- opportunity to ask questions
- comprehension of consequences
- voluntary agreement

The Code of Ethics makes this explicit. Standard 4 requires advisers to act only with free, prior and informed consent, and to have reasonable grounds for believing that consent has been obtained (FASEA, 2019).

This is a higher standard than disclosure. It requires advisers to form a judgement about the client's understanding, not merely to provide information. Ethically, advisers must do more than explain, they must confirm comprehension.

Introducing the Two Sentences Test

The Two Sentences Test is a practical method for evidencing understanding in real advice conversations. After explaining a strategy, the adviser asks the client to explain it back in two sentences:

1. **What will happen**
2. **Why it matters**



If the client cannot do this accurately, understanding has not yet been achieved.

This is not a test of intelligence, education or financial literacy. It is a test of communication effectiveness. If a client cannot summarise the outcome in their own words, the adviser's explanation has not yet landed.

Importantly, the test does not require perfect technical language. It requires conceptual understanding.

Why this matters most in tax advice

Tax strategies are particularly vulnerable to misunderstanding because:

- outcomes are often delayed
- consequences are indirect rather than immediate
- benefits are framed positively
- downsides are abstract or probabilistic

Clients may focus on projected tax savings without appreciating liquidity impacts, timing risk, loss of flexibility, or estate consequences. They may agree to strategies that are irreversible or difficult to unwind.

The Two Sentences Test forces these issues to the surface. When clients attempt to explain “what happens” and “why it matters”, gaps in understanding become immediately apparent to both client and adviser.

Regulatory defensibility

From a regulatory perspective, the Two Sentences Test strengthens compliance in several important ways:

- It demonstrates adherence to Standard 4 of the Code of Ethics
- It supports the best interests duty by evidencing understanding
- It strengthens file notes and advice records
- It reduces complaints, disputes and remediation risk

ASIC and AFCA assess advice outcomes retrospectively. When disputes arise, the question is often not “Was the advice disclosed?” but “Did the client understand what they were agreeing to?” Evidence that the adviser tested and confirmed understanding at the time the advice was given is one of the strongest defences available.

Practical application in advice meetings

The Two Sentences Test should be applied:

- after explaining a strategy
- before implementation
- particularly where decisions are irreversible or long-term

If the client struggles, the adviser should:

- re-explain in simpler language
- use analogies or practical examples
- break the strategy into components
- delay implementation if necessary

Importantly, failure of the test is not a failure of the client. It is feedback for the adviser that further explanation is required.

Ethical courage: slowing the process

The greatest challenge in applying the Two Sentences Test is resisting time pressure. Advisers may feel compelled to move forward once documents are prepared or deadlines loom. However, ethical practice requires advisers to prioritise understanding over momentum.

ASIC has emphasised that advice quality is not measured by speed, but by suitability and outcomes (ASIC, 2024). Slowing the process to confirm understanding is not inefficiency...it is professional diligence.

In some cases, ethical courage means pausing implementation even when the advice is technically ready.

Documentation and professional judgement

To support ethical accountability and regulatory defensibility, advisers should document:

- the explanation provided
- the client's explanation in their own words
- any clarifications required
- the adviser's judgement that understanding was achieved

This documentation demonstrates professional judgement and supports compliance with both the Corporations Act and the Code of Ethics.



Conclusion

The Two Sentences Test is deceptively simple. It does not replace technical expertise, compliance processes or documentation. Instead, it complements them by addressing the ethical core of financial advice: **client understanding**.

In an environment of increasing complexity, regulatory scrutiny and professional expectation, advisers who ensure that clients can explain the tax outcomes of their advice are not only more ethical, but they are also more defensible, more trusted and more professional.

In the end, informed consent is not proven by what advisers say.
It is proven by what clients can explain.

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You are welcome to reach out to discuss:

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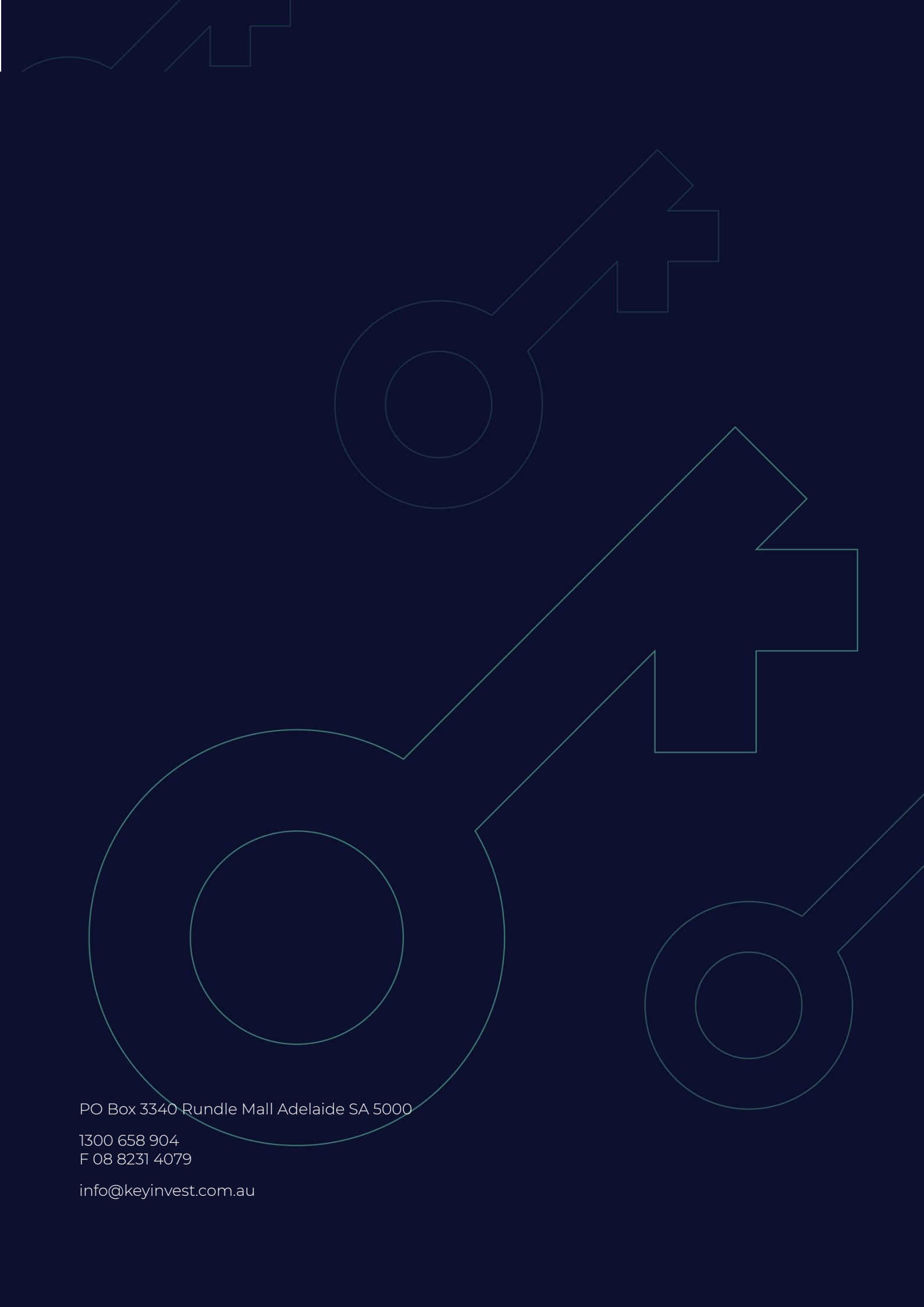


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