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The Financial Advice Industry Post FoFA

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1. Executive Summary

1.1 Our Brief

Rice Warner has been engaged by Matt Linden and Robbie Campo of Industry Super Network (ISN) to estimate the impact of the potential Future of Financial Advice (FoFA) changes on the financial advice industry.

Our report *Transformation of the Financial Advice Industry, March 2010* (the March 2010 report) assessed the impact of potential regulatory changes as envisaged at that time. This report represents an update of the March 2010 report reflecting:

- up to date market information at 30 June 2011
- the proposed FoFA changes being significantly different from those envisaged when the March 2010 report was written.

For the purposes of clarity, we have included much of the background information that was contained in the March 2010 report. Consequently, the current report can be read in isolation. However, references are made to the earlier report when discussing the rationale for some of the assumptions made.

It should be noted that this report does not express any views on the merits or otherwise of the draft legislation or recommend any changes to it. Furthermore, we have not commented on the broader regulatory environment affecting the provision of financial advice. Such topics fall outside the scope of this report.

However, we do provide our views on the impact of the specific regulatory changes envisaged in the current draft legislation upon the development of the financial advice industry.

1.2 Key conclusions

1.2.1 Shift in Advice

Under the current regulatory regime, the primary distribution model for retail sector superannuation and wealth management products consists of networks of financial planners incentivised through commissions paid by the product/platform provider to their licensee or asset-based fees.

Revenue for advisers is typically drawn from a complicated combination of upfront and ongoing dollar and asset-based payments.

The proposed FoFA reforms are described in Section 2 (The FoFA and Related Regulatory Changes) but the key changes are:

- the introduction of a 'best interests' obligation on financial advisers;
- a ban on all payments from dealer groups, platform providers and product providers to financial advisers;
- grandfathering of existing trail commission and other existing remuneration arrangements; and
- a requirement for clients to opt in for ongoing advice.

On average, the price of financial advice is expected to be lower after these regulatory changes with the reforms facilitating a shift towards less costly scaled advice and more transparent charging for complex advice. While increased transparency may result in a perception of higher cost for complex advice, fee for service charging is in most instances less costly for the client over the medium to long term than trail commissions or asset based fees[1]. While there is a risk of reduced demand for comprehensive advice, this report finds demand for comprehensive advice will be broadly stable after the regulatory change.

Increasingly, many new clients will be satisfied with simple pieces of advice targeted to their needs at different points of their lifecycle. Consequently, there will be a shift from full service advice to scaled advice delivered periodically throughout a client's lifetime. Further, we expect the number of Australians taking advantage of scaled advice will grow.

Full service advice will still be required and provided for people with complex financial and/or family arrangements. In these circumstances, the adviser will spend considerable time reviewing the client's circumstances and will often need to draw on deep technical experience in order to tailor a specific financial solution for them. This group of clients will be willing to pay fees commensurate with the scope of the advice provided. However, many clients will choose scaled advice rather than commit to a holistic service. As circumstances change, many of these will purchase scaled advice several times over their lifetime.

This report finds that the regulatory changes are likely to lead to an increase in the total number of pieces of financial advice given to Australians. By 2025/2026 it is estimated that 1.77 million pieces of advice will be provided – more than double the 831,000 pieces of advice under a no reform scenario. This is mainly driven by the high increase of scaled advice from 170,000 pieces in 2025/2026 under a no reform scenario to more than 1 million with the reform.

Additionally the increased provision of more affordable scaled advice will result in a significant reduction in the average cost of advice from an average of $2,135 before the reforms to $1,188 after the reforms by 2025/2026, in 2011 dollars.

1.2.2 Advice as a Growth Industry

The superannuation industry will grow substantially over the next 15 years with assets expected to increase by 9.6% per annum. The continued aging of the population and the maturation of the superannuation system, including the phased increase of the Superannuation Guarantee from 9 to 12%, will be significant drivers influencing demand for financial advice. These factors will drive an increase in the average superannuation account balance towards retirement and increased engagement from consumers as they consider the best use of these savings. At the same time, we expect the overall efficiency and productivity of financial advisory groups to increase substantially, driven by:

- Technology improvements;
- Consolidation in the financial advice industry, which is already underway; and
- Simplification of the regulatory framework surrounding the provision of advice which is also underway. For example, intra-fund advice rules have recently been clarified and simplified. This has allowed superannuation funds to provide advice more quickly and with less paperwork – that is, with streamlined Statements of Advice.

These factors mean that there remains significant scope for financial advisers to maintain and develop viable businesses, even if product manufacturer payments are banned for new business.

[1] Rice Warner Actuaries, May 2011, *Value of IFFP Advice*

1.2.3 The Growth of Scaled Advice

At the same time, superannuation funds and other financial institutions will continue to grow their 'scaled advice' services. As a result of member education and targeted campaigns, we expect the number of scaled Statements of Advice to increase substantially over the next 10 years, although this growth will be slow in the early years as superannuation funds and wealth managers:

- develop and refine their advice business models;
- recruit and train appropriate advisers; and
- enhance administration systems to provide easy access to member data to support the advice process.

1.2.4 Consumer Reaction to Possible Regulatory Change

With explicit fees, many people will assess the cost of the service. Many will have relatively simple needs and will conclude that they do not need comprehensive financial advice as traditionally provided by financial advisers. This is supported by research carried out by ASIC[2] which suggests that around one third of people have a preference for receiving advice piece by piece and 25% prefer not to receive advice. This suggests that around 44% of those who seek advice would prefer to receive it piece by piece.

Some of these people will turn to their superannuation funds or other trusted financial institutions where scaled advice can be provided cheaply, mainly because it is single issue or intra-fund advice. Others will simply not seek advice at all, relying primarily on their superannuation fund to provide high quality default investment and insurance benefits.

Some sections of the financial advice industry have suggested that a ban on product provider payments and the introduction of the proposed opt-in rules would lead to a significant decline in the number of people obtaining advice. Our projections show that the demand for full (holistic) advice is likely to be broadly stable whilst the demand for scaled advice will increase substantially, to the point where **one in twelve people** across the overall population or **one in seven employed people** will obtain regulated financial advice each year.

Undoubtedly, there will be some elasticity of demand for full advice with a number of clients who would have obtained advice under the current regulatory regime choosing not to do so once they understand the fees involved. However, others who are currently deterred from obtaining advice will decide to seek advice once their perception of potential bias is removed. A detailed discussion of price elasticity for financial advice is set out in Section 9.2.3.

The growth in single issue advice will come from two main sources, namely industry fund members and bank customers. A further group will be existing customers of advisers who are inactive and may be interested in reviewing their existing arrangements.

1.2.5 Impact of Change on Industry Employment and Productivity

As noted above the key drivers of an aging population and maturing superannuation system set the backdrop for the FoFA reforms. These factors will ensure there are significant opportunities for growth in the financial advice industry. In respect to the specific impact of the FoFA reforms the extensive grandfathering of existing business means that any change to the financial advice industry will be gradual.

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2 *Report 224, Access to Financial advice in Australia, December 2010 (Figure 4).*

While it is difficult to make highly precise estimates of employment impacts (especially over the long term) this report finds that with the FoFA reforms there is likely to be short term boost to total adviser employment before settling toward a total level of employment broadly similar to the levels existing today. For example after 10 years, total adviser employment is estimated to be 17,068 at 30 June 2022 compared to 17,711 at 30 June 2012.

The short term boost to adviser employment occurs under the reforms because the trend towards a fee for advice model involves the bringing forward of fee revenue compared to trail commissions or asset based fees, even though it is less costly to the consumer over the medium to longer term. In the short term this may attract additional advisers to the industry though this effect might be reduced if advice fees are paid in instalments over a period of time (say two to three years).

Over the full timeframe of this analysis, through to 2026, total employment of advisers may be slightly lower (by 5%). However the outcome will depend on the commercial strategies formulated in response to reforms. For example, some industry participants are already recognising that scaled advice clients may be more receptive to full advice at some point which will lead to a higher take-up of full advice.

The sensitivity of our projections to a higher take-up of full advice provided in Section 11 (Sensitivities) suggests an increase in demand for full service advice flowing from such a commercial strategy may lead to a higher total level of employment in the long term (18,397 by 30 June 2022) compared to today (17,711 at 30 June 2012).

It can be said with more certainty that the FoFA reforms will lead to a change in the composition of advisers. For example, we anticipate that, after implementation of the FoFA changes, the number of **full-service** financial advisers, currently around 17,300, is likely to remain broadly unchanged in 5 years time and will then decline to around 14,300 in 2026. However this will be offset by an additional 2,200 advisers providing **scaled advice** to clients/fund members as the provision of such advice becomes more accessible and grows to meet the demand for such advice

It is likely that dealer groups will develop scaled advice models to support their existing and prospective customers who have simple needs. Thus, some may continue to grow their adviser numbers in aggregate, but there will be a shift towards scaled advice.Our projections show similar levels of full advice being provided by a declining number of full-service advisers; in other words, an increase in the marginal productivity of full-service advisers. This reflects the fact that many full advisers currently rely on substantial trail commissions and platform rebates to sustain their businesses and, after the regulatory change, advisers will be compelled to demonstrate the value of their services in order to retain and attract clients. Successful adviser practices will be those which focus on providing quality advice at a competitive price, assisted by efficiency improvements.

Table 1 shows estimated commission and other product provider payments and fees for service under the current regulatory regime projected out for the next 15 years. It compares this with the corresponding amounts estimated to be paid after the proposed regulatory changes have been implemented.

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Table 1. Estimated Commission and Fees – in Future Dollars

12 Months to 30 June	Before Regulatory Change	After Regulatory Change	Reduction	Reduction	Av. Payments per Adviser p.a. Before Regulatory Change	Av. Payments per Adviser p.a. After Regulatory Change
	($M)				($'000)	
2012	3,302	3,302	0	0%	188	188
2013	3,569	4,295	-726	-20%	202	243
2014	3,860	4,489	-629	-16%	217	209
2015	4,175	4,516	-341	-8%	233	207
2016	4,518	4,522	-4	0%	250	212
2017	4,890	4,525	365	7%	269	227
2018	5,292	4,551	740	14%	289	243
2019	5,726	4,775	951	17%	310	271
2020	6,178	5,079	1,099	18%	333	294
2021	6,660	5,398	1,262	19%	357	313
2022	7,181	5,734	1,447	20%	384	334
2023	7,745	6,088	1,657	21%	412	357
2024	8,352	6,460	1,892	23%	443	380
2025	9,007	6,851	2,156	24%	476	405
2026	9,709	7,260	2,449	25%	511	431

Note: Average adviser payments stated in the table above are combined averages across both full and scaled advice and advisers. The increase in average payments per adviser to $232,000 in the 12 months to 30 June 2013 is because the average is based on the number of advisers at the start of each year.

Table 2 shows the same information as Table 1, but expressed in 2011 dollars.

Table 2. Estimated Commission and Fees – in 2011 Dollars

12 Months to 30 June	Before Regulatory Change ($M)	After Regulatory Change ($M)	Reduction ($M)	Reduction	Av. Payments per Adviser p.a. Before Regulatory Change ($'000)	Av. Payments per Adviser p.a. After Regulatory Change ($'000)
2012	3,206	3,206	0	0%	182	182
2013	3,364	4,048	-684	-20%	190	229
2014	3,533	4,108	-576	-16%	198	191
2015	3,709	4,012	-303	-8%	207	184
2016	3,897	3,901	-4	0%	216	183
2017	4,095	3,789	306	7%	225	190
2018	4,302	3,701	602	14%	235	198
2019	4,520	3,770	751	17%	245	214
2020	4,735	3,892	842	18%	255	225
2021	4,956	4,017	939	19%	266	233
2022	5,188	4,142	1,046	20%	277	242
2023	5,432	4,270	1,162	21%	289	250
2024	5,687	4,399	1,288	23%	302	259
2025	5,955	4,529	1,425	24%	315	268
2026	6,232	4,660	1,572	25%	328	277

Note: Average adviser payments stated in the table above are combined averages across both full and scaled advice and advisers. The increase in average payments per adviser to $218,000 in the 12 months to 30 June 2013 is because the average is based on the number of advisers at the start of each year.

After the regulatory change:

- There will a net increase in the amount of advice provided. By 2017, 310,000 additional pieces of advice will be provided and by 2026, 940,000 additional pieces of advice will be provided.
- The introduction of more efficient adviser delivery models for scaled advice combined with productivity and efficiency improvements will lead to both scaled and comprehensive advice being provided where there is demand for each. The higher overall volumes of advice will be provided through broadly similar numbers of advisers with the final outcome dependent on commercial strategies formulated in response to the reforms.
- Average adviser remuneration, across both full and limited advisers, will still increase in real terms, although by significantly less than would be the case under the current regulatory environment. In essence, a commission based model in a growing superannuation and risk insurance market leads to 'system growth' in adviser remuneration that would be removed under a fee based model.
- As with any major transformation, the people participating in the advice industry may change significantly because the characteristics of a high quality salaried adviser may differ from those of a successful full service financial adviser.

- The reduction in overall adviser remuneration will be $1.6 billion (in 2011 dollars) in 2026 (or $2.4 billion in future dollars) representing 0.08% of GDP[3]. This amount will flow directly into increased superannuation and other savings by individuals. It will also have secondary impacts on the economy through a diversion of adviser payments to private savings. We have not attempted to quantify these impacts.
- Nevertheless the retention of fee revenue by individuals and the broader provision of advice across the community will mean the reforms will increase the level of private savings by an estimated $130 billion by 2026.

1.2.6 Comparison with the March 2010 report

The key differences in the results presented in this report compared with those in the March 2010 report are:

- The number of financial advisers at 30 June 2011 is estimated to be 17,600, compared with 16,291 estimated in the March 2010 report. This reflects stronger growth in adviser numbers over the past two years than had been anticipated.
- The March 2010 report estimated that the number of advisers in the market would reduce by 23% over the 14 years following the regulatory change. The current report estimates that the number will be broadly stable with the final outcome subject to commercial strategies in response to the reforms. This reflects the fact that the March 2010 report assumed a ban in commissions in respect of retail risk insurance and a ban on asset based fees, whereas the current report reflects the proposed FoFA legislation which does not include such bans. We note, in particular, that risk insurance currently generates around 40% of adviser revenue.

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3 Assuming growth in real GDP as in the 2010 Intergenerational Report

2. The FoFA and Related Regulatory Changes

At the time of writing, the FoFA draft legislation has been tabled in Parliament in two tranches and the parliamentary joint committee on corporations and financial services is now reviewing it. Public hearings are due to take place on 23 January and 24 January 2012.

For the purposes of this report we have taken account of the following key changes:

- The introduction of a best interests obligation on financial advisers to take reasonable steps to act in the best interests of the client and give priority of the interests of the client in the event of conflict.
- A ban on all payments from dealer groups, platform providers and product providers to financial advisers, except in relation to:
  - individual risk insurance
  - general insurance
  - execution only services.

  Such payments are described as 'conflicted remuneration'.
- A ban on all soft dollar benefits except in relation to:
  - general insurance products
  - items under $300
  - genuine education and training relevant to the provision of financial advice to retail clients
  - IT software and support relating to the provision of financial product advice.
- Grandfathering of existing trail commission and other conflicted remuneration arrangements[4] entered into before 1 July 2012 (or 1 July 2013 in respect of group risk insurance products within superannuation).
- Asset based fees will continue to be permitted but any ongoing fees will be subject to opt-in by the client on a two yearly basis with the first opt-in, in effect, occurring at 1 July 2014 (two years after the first advice is provided under the new regulatory regime).
- A ban on asset based fees in relation to borrowed amounts.

We have received feedback from some industry participants regarding the draft fiduciary duty obligation and best interest rules. In particular, there is concern that, as currently drafted, these would make it difficult to provide scaled advice. The detailed rationale for this view is beyond the scope of this report. However, the key issues are the requirement for the adviser to, in effect, assist the client in determining the scope of advice and the broad definition of fiduciary duty which would be subject to interpretation by the courts. However, other super funds who are already providing scaled advice services to members (and who have always been subject to SIS 'best interests' duties as the advice is provided by or on behalf of the trustee) do not believe there is any incompatibility between the best interests obligation and delivery of scaled advice.

Nevertheless, it is clear from government statements[5] that the government intends to implement the regulatory reforms, through a combination of legislation and ASIC regulatory guidelines, in such a way as to encourage the provision of scaled advice. On this basis we

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4 Although platform rebates would not be grandfathered, except via regulatory exemption.

5 For example, the media release dated 8 December 2011 by Bill Shorten, then Assistant Treasurer and Minister for Financial Services and Superannuation entitled *Improving Access to Simple Financial Advice.*

have assumed that the fiduciary duty and best interests tests legislation does not present an impediment to the development of scaled advice services, although we have provided an analysis of the sensitivity of our advice market projections to a slower take up of scaled advice over time if, indeed, providers need to take a more cautious approach to the development of such services (see Section 11 Sensitivities).

The government's proposed stronger super changes include the development of a MySuper product with a requirement for all default superannuation contributions to be made to a MySuper account from 1 October 2013. All existing default superannuation account balances will have to be transferred to MySuper by 1 July 2017. This will mean that, whilst grandfathering of existing commission arrangements in respect of default superannuation arrangements will apply until 1 July 2017, from that date all such business will have to be transferred to a MySuper account under which no commission (or other conflicted remuneration) can be paid. As such, the grandfathering of commission under default superannuation arrangements will cease on 1 July 2017.

Whilst this change is not technically as a result of the FoFA legislation, we have taken it into account in assessing the development of the financial advice industry within this report. Having said that, the impact is not material because natural staff turnover means that a high proportion of employees in commission based default superannuation arrangements at 1 July 2012 will have moved into post 2012 arrangements before 2017.

3. Terminology

Throughout this report we have used the following terms with the means noted:

- **Scaled advice** means either scaled advice or intra-fund advice. Scaled advice is often referred to within the industry by alternative terms such as scalable advice, scoped advice or scaled advice and relates to advice on single issue of importance to the client or a limited range of issues, as opposed to holistic financial advice which takes into account the client's entire financial needs.
- **Full advice** means any advice that is not scaled advice. In practice, this will range from the provision of a holistic financial plan covering all aspects of the client's financial needs down to more tailored financial plans covering some but not all needs. This differs from the legislative and regulatory definitions which classify anything other than holistic financial advice as scaled (or intra-fund) advice. We have adopted this definition to ensure that all advice provided by current independent financial advisers, for example, is classified as full advice whereas in practise.
- **Scaled adviser** means an adviser, typically and authorised representative of a superannuation fund, wealth manager or bank licensee, who primarily provides scaled advice.

  Usually, scaled advisers only respond to enquiries from customers of the institution that employs them. However, active or out-bound marketing of advice services is becoming more common.

- **Full service financial adviser** means a financial adviser providing full financial advice covering the client's overall financial needs. Full service financial advisers typically provide the whole range of financial advice, ranging from scaled advice at the one extreme to full, holistic advice at the other. Nevertheless, for the purposes of this report we have classified all such advisers as full service financial advisers.

  Full service financial advisers are usually authorised representatives either of dealer groups, aligned to a particular product provider (usually to a parent bank or life insurer) or a superannuation fund or master trust manager. Until the last few years, most were remunerated in the form of commission many have now migrated to fee based remuneration models and some are salaried.
- **Pre 2012 arrangements** means advice provided and resulting products acquired under financial advice remuneration structures arranged up to 1 July 2012 (or 1 July 2013 in the case of group risk insurance). This includes, for example, advice provided and resulting products acquired after 1 July 2012 under arrangements entered into prior to 1 July 2012.
- **Post 2012 arrangements** means any advice provided or resulting financial products acquired which are not classified as pre 2012 arrangements.

- **Commission** means payment to a dealer group or adviser by a product provider that may be designed to remunerate them for the provision of financial advice, procurement of business or maintenance or retention of business. Commissions may be either:
  - **up front commission** – paid on new product sales or increases to existing contracts
  - **trail commission** – paid on an ongoing basis, typically related to the size of the client's business measured in terms of fund size for investment and superannuation business or premiums for risk business.
  - For ease of discussion in this report, we have used the term 'commission' to include platform or fund manager rebates to dealer groups.
- **Fee** means a payment to an adviser by their client for the provision of advice. Fees are negotiated between the client and their adviser.

- **Upfront fees** may be paid for carrying out a financial needs analysis and providing a Statement of Advice.
- **Asset-based fees** may be paid on an ongoing basis and be related to the size of the client's business.

Adviser remuneration figures (e.g. commissions and fees) quoted in this report are the amounts paid to the relevant dealer group and are therefore before any 'dealer cut' that the dealer group retains to cover its costs. Dealer cuts currently range from 5% to 12% depending on the particular adviser and dealer group, although lower dealer cuts apply to some high volume advisers.

4. Changes since the March 2010 Report

The draft FoFA legislation differs significantly from the regulatory changes anticipated at the time of the March 2010 report. As a result, we have made some significant changes to our assumptions underlying financial advice market projections.

The key changes since the March 2010 report are discussed.

4.1 Starting position

The March 2010 report had a start date of 30 June 2009. The current report has been updated to reflect the starting position of 30 June 2011. This has meant that many assumptions have been changed including:

- the number of advisers in the market
- the number of people who have received financial advice
- average fee levels for advice
- the take up of scaled advice
- funds under management in respect of superannuation and managed investment business and in force premiums in respect of risk insurance business.

4.2 Risk insurance commissions to continue

The March 2010 report assumed that the ban on payments from product providers to advisers would also apply in relation to risk insurance business as well as to other financial products such as superannuation and managed investments. The draft FoFA legislation envisages continuation of a commission regime for all life risk insurance except group risk insurance for members of superannuation funds.

This means that the current report shows less fee-based advice in the future than the March 2010 report, reflecting the retention of commission arrangements in respect of retail risk insurance business.

4.3 Asset based fees

The March 2010 report assumed an effective ban on asset based fees as it was assumed that fees could only be charged at the point in time when specific advice was provided. However, the draft FoFA legislation permits ongoing fee arrangements between advisers and their clients, subject to the client 'opting in' to such arrangements once every two years.

Grandfathering arrangements will ensure that this will only apply to new arrangements entered in to after 1 July 2010 with existing commission or fee arrangements without opt-in applying to arrangements entered in to before that date[6].

The impact of this change is that we have now allowed for asset based fees to be paid on arrangements entered in to after 1 July 2012 (post 2012 arrangements) which had not been anticipated in the March 2010 report. However, we have assumed that only 50% of new clients

[6] The Bill (page 8) states that opt-in only applies where 'the client has not been provided with personal advice as a retail client' before 1 July 2012. Consumer groups are pushing for a tighter definition of 'existing client' because the current definition would classify inactive clients as existing clients. They have suggesting that the Bill should be amended to apply the renewal notice requirements to all clients who enter into a new ongoing fee arrangement on or after the day the new rules come into effect.

opt for ongoing advice (and therefore ongoing, asset based fees) and, at each subsequent opt in date only 80% of those previously receiving ongoing advice opt to continue the arrangement.

4.4 MySuper

Technically, the introduction of MySuper products falls under the government's stronger super reforms rather than FoFA. However, as discussed in Section 2(The FoFA and Related Regulatory Changes), the transfer of all existing default superannuation accounts to MySuper by 1 July 3013 will mean that the grandfathering of existing commission arrangements in relation to such business will also cease at that date.

The impact of this reform is likely to be small in the context of the overall market, although it is material for adviser groups whose business models are focused on employer superannuation business. Nevertheless, we have allowed for the impact of the move to MySuper in the projections contained in this report.

Having said that, the impact is not material because natural staff turnover means that a high proportion of employees in commission based default superannuation arrangements at 1 July 2012 will have moved into post 2012 arrangements before 2017.

4.5 Increase in superannuation guarantee

The March 2010 report assumed continuation of the superannuation guarantee at the rate of 9% of salary (subject to statutory minimums, maximums and eligibility). Legislation to increase the superannuation guarantee gradually to 12% of salary by 2019-2020 has now been supported by both sides of politics and we have allowed for this in the current report.

4.6 New labels

The March 2010 report used the term simple advice to describe what, in future, will either be termed scaled advice or intra-fund advice. In the current report we will use the term 'scaled advice' consistently to mean both scaled advice and intra-fund advice.

It should be emphasised that, for simplicity, our financial projections make a distinction between scaled advice and full advice but, in reality, there is an entire spectrum of advice complexity rather than these two simple extremes. Clearly it is not possible to sub-divide advice into a large number of different sub categories so the distinction between scaled advice on the one hand and full advice on the other is a pragmatic one for the purposes of this report.

The definition of scaled and full advice respectively is set out in Section 2 (Terminology).

5. The Current Advice Market

The delivery of professional financial advice provides an experienced, disciplined and informed structure to the financial management of a client's affairs. Financial advisers assist their customers in making and implementing financial decisions to help them meet their long term objectives. This involves identifying the customer's goals, setting strategies to meet them, then managing the risks and methods to achieve the goals.

Ongoing regular advice will involve evaluating progress towards the goals and adjusting the strategies.

The growth of average superannuation account balances coupled with the development of scaled advice models means that there will be an increasing amount of scaled advice provided.

The delivery of financial advice is closely regulated and the legislation requires various documents to be provided to prospective and existing clients at various times.

5.1 Financial Advice Models

The traditional financial planning model is a full service face-to-face relationship between an adviser and their client. Over the last decade, advice has shifted from choosing investment, superannuation and insurance products to more holistic strategies.

Remuneration models now vary. Until recently, most remuneration was based around payments built into product fees as commission. These could be initial amounts (based on the investment made by the client) or ongoing asset-based trail commissions. However, remuneration is shifting to fee-based up front advice and retainers, although these may still be based on the size of a client's investment portfolio.

The FSC Super Charter required FSC members to replace commissions with Member Advice Fees and, for Corporate Superannuation business, Plan Service Fees (and members must comply with this standard by 1 July 2012). Fees have to be agreed with the client (or the employer for Plan Service Fees) and can be up front at the time the advice is given and/or ongoing. Ongoing fees can be dollar based or a percentage of assets in the member's account at each regular fee date.

The financial outcome under the FSC Super Charter can be the same as under the current commission structure. Upfront fees can be negotiated with the client to be equivalent to the upfront commission that would have been paid under the old regime. Member Advice Fees and Plan Service Fees can be negotiated to be the same as the equivalent trail commission. However, new clients do have better visibility of the fees charged and have a chance to negotiate them. Also, Corporate Plan members can opt out of the Plan Service Fee.

However, the FSC Super Charter does not include a requirement for the client to opt in for ongoing advice.

As stated in Section 2 (The FoFA and Related Regulatory Changes), within this report we have tested an alternative model under which fees could only be charged where specific advice is provided, they are paid directly by the client to the adviser and ongoing fees are subject to the client opting in for ongoing advice.

5.2 Scaled Advice Models

5.2.1 Demand for scaled advice

The demand for financial advice will vary between different groups of people. Although everyone would benefit from regular advice throughout their adult life, it is often only those who already have substantial assets who have a financial planner. For example, a report by IBISWorld[7] stated that advisers only service around 40% of their clients regularly. Thus, many people pay for an ongoing service but they don't receive regular advice during their adult careers.

This does not mean that a comprehensive financial plan is required in all cases. It is primarily those who are relatively well off or close to retirement who need complex ongoing advice. The 'gap' in the current market is in the provision of scaled advice on key financial decisions facing average Australians, such as:

- how much to contribute to super to achieve their desired retirement lifestyle
- how much insurance cover is required to provide for family members and dependants
- how to benefit from government incentives such as co-contributions.

The growth in superannuation balances has encouraged many superannuation funds, wealth managers and banks to set up financial advice services. These have been structured around single issues and are based on the assumption that clients at similar life stages will often have similar goals and objectives. If the circumstances of these clients are broadly homogeneous, the provision of this scaled advice will be good advice notwithstanding that a full analysis of their personal circumstances has not been carried out.

A typical breakdown of the different demographic groups is:

- Young singles starting out in life (these are targets for budgeting, debt management and superannuation co-contributions).
- Young married couples who are building careers and families (targets for voluntary superannuation contributions and life insurance).
- Asset Builders - adults accumulating assets such as a family home, investment property or small business (targets for salary sacrifice and higher levels of insurance).
- Mature people needing to increase their superannuation (targets for salary sacrifice).
- Transitional era -members winding down work and beginning to consume their superannuation (targets for Transition to Retirement strategy).
- Retirees – people who will move through the three distinct phases of retirement, *Active, Passive, Frail* (targets for retirement income strategies).

Although traditional financial planning is built around a holistic view of the individual's circumstances, scaled advice models do ensure that people receive some advice. For example, young people on low salaries might be able to make use of the co-contribution; married couples should review their life insurance needs and older workers may need to increase their superannuation savings through salary sacrifice.

5.2.2 Delivery of Scaled Advice

Scaled advice models are useful where the provider has a large customer base. The entities with the best opportunities are banks and industry funds.

7 Money Management 14th January 2010.

Scaled advice is usually structured around Call Centres. There may be in-bound requests for advice or outward-bound campaigns can be held, based on data mining of customers.

All call centre operations require the appropriate investment in telephony linked with computer hardware and software support. The provision of general advice and factual information requires help screens and links to computer records. Access to tools such as calculators and 'prompt' screens is needed to be able to respond to common issues.

The selection and training of people is an ongoing issue. The market has a shortage of appropriately skilled individuals with the desired profiles to provide assistance.

Call centres that focus on scaled advice can also be a source of referrals for face to face advice. Many issues are too complex to discuss without knowing more about a person's personal circumstances and discussing the options with them. So scaled advice does not replace comprehensive or holistic advice where needed but the scaled advice process channels the client to the type of advice required. Indeed, scaled advice clients may subsequently require full advice which will lead to a higher take-up of full advice. The sensitivity of our projections to a higher take-up of full advice is provided in Section 11 (Sensitivities).

5.2.3 Fee Structures

Scaled advice is usually provided on a fee for service basis, often for a fixed fee that might vary from $200 to $1,500 depending on the nature of the advice. A few superannuation funds provide scaled advice 'free' with the cost, in effect, being borne by all members out of the normal administration fee.

We expect the amount of scaled advice provided across the market to increase substantially over the next ten years, although this growth will be slow in the early years as superannuation funds and wealth managers:

- develop and refine their advice business models
- recruit and train appropriate advisers
- enhance administration systems to provide easy access member data to support the advice process.

6. The Transformation

6.1 Existing Holistic Clients

There is an old industry adage describing financial planners. Generally, many people believe them to be rogues who over-charge and should not be trusted. However, this is usually followed by the comment that 'I am lucky that mine is different'. The paradox arises from the poor media commentary about the financial planning industry and the perceived bias in the advice process as a result of current remuneration structures compared to the recognised value of the ongoing advice received by many clients.

Clients receiving holistic advice may meet with their adviser at least once a year. Over time, they build a trusting relationship. However, many are often unaware of the price they are paying for the service. Clients could pay a combination of upfront fees and trail commission without understanding the true costs of the service provided.

Under a proposed FoFA legislation, with more transparent fees, there is a range of outcomes from existing clients:

- some clients will negotiate a lower fee once they realise how much they are paying
- some clients will shop around to obtain a lower price for the advice service
- some will continue under the new basis.

It is also possible that some clients will discontinue any existing arrangement and either:

- seek advice as and when required, or
- seek no advice.

The transformation of the financial advice industry will depend in part on the actions taken by these clients and their current advisers. Under the proposed 'grandfathering' arrangements, we believe that few clients will seek to terminate existing commission arrangements and will continue to pay commissions and other forms of adviser remuneration even if they receive no financial advice. However, many of those who are not currently serviced actively by their advisers will seek scaled advice from their superannuation fund, bank or wealth manager as the availability and knowledge of such services increases.

We note that under the current regime platform providers often provide a rebate of part of the platform fee to the dealer group, depending on the amount of business that dealer group holds on the platform. This provides bias away from alternate products.

Under the new regime, it will be more difficult to hold an adviser to a particular platform as their fee will be paid irrespective of the investment or superannuation fund chosen. We expect dealer groups will require a higher share of the adviser fee to compensate for this. This could lead to higher adviser fees but lower platform fees.

6.1.1 Negotiation

Within the market, some advisers have already cut their clients' overall fees by shifting investments to lower-cost indexed funds or by moving them off investment platforms into vehicles such as an SMSF. Others have moved their own remuneration basis to a flat fee, albeit usually related to the size of assets invested.

Further, people with complex needs and significant assets are informed enough to ask about costs and may well negotiate a better price.

6.1.2 Shopping Around

We do not believe many clients will shop around to get a better deal. They would not know where to find a trusted replacement adviser. Consequently, they are more likely to negotiate.

6.1.3 Cessation of Current Arrangements

Some clients will discontinue current arrangements and seek advice as and when required on a 'one-off' basis, e.g. approaching age 55 to consider transition to retirement strategies. There is anecdotal evidence that clients are already restricting their use of advisers to particular crucial points in their life, such as the point of retirement.

6.2 Future Holistic Advice Clients

There are many people with complex financial and family affairs. Their circumstances require analysis before advice can be provided. Some of the items falling into this category are:

- Estate planning where there are dependants from more than one marriage or where there are disabled dependants.
- Complex financial arrangements for those who:
  - are self-employed
  - have a family trust
  - have negatively-geared investments;
  - manage a farm
  - have significant family wealth.

Senior executives who are time-poor but want regular advice on tax and other financial matters. These groups will continue to want a relationship with a trusted adviser with regular updates on their affairs. It is uncertain how sensitive this group will be to the cost of advice but it is likely that many will negotiate a lower fee in a more transparent environment.

6.3 Impact on Different Types of Superannuation Client

Mandatory employer contributions have made superannuation the dominant form of savings for most Australians. As funds grow and offer more services, many financial needs will be met through the provision of scaled advice.

Financial planning extends beyond superannuation so funds cannot provide all advice – to do so would constitute a breach of the sole purpose test under the Superannuation Industry (Supervision) Act. Further, with couples, funds don't often have the superannuation of both partners. Consequently, the information required to provide a comprehensive plan is not immediately available.

Nonetheless, scaled advice (and, specifically, intra-fund advice) on superannuation issues can be provided to individuals and this will become the dominant channel for dealing with members.

Within the retail sector, advisers sometimes treat the employer as their client (for example, where the relationship is with a large employer) and sometimes the individual (for example, self-employed people). Members of employer based plans can obtain advice but many do not receive it as they are unaware of the service (or don't require it). As MySuper is introduced and commission is withdrawn, we expect that many advisers will withdraw from the corporate superannuation market to focus on individuals.

Many members of retail corporate superannuation funds are transferred to personal products on leaving their employer (colloquially known as ‘flipping’). In some cases this triggers the payment of commissions to an adviser even though financial advice may not have been provided. Once again, this process will cease once the MySuper legislation is enacted which, amongst other things, prevents the automatic transfer of a MySuper member’s account to anything other than another MySuper account.

7. The Size of the Current Advice Market

In this section we describe the assumed structure and characteristics of the current financial advice market.

7.1.1 Number of Full Service Financial Advisers

We have assumed that the number of financial advisers in the Australian market at 30 June 2011 was 17,300. The figure is broadly consistent with that published by other research providers such as Rainmaker and DEXX&R. It should be noted that there are substantially more than 17,300 authorised representatives in the market. However, a higher proportion of them sell little or no business, so 17,300 has been adopted as a measure of what might be described as 'active financial advisers'.

7.1.2 Number of Scaled Advisers

In addition, the current number of salaried financial advisers giving scaled is estimated to be 300. This includes advisers in IFFP, Money Solutions, QInvest, Mercer, Plum, Colonial First State and many individual superannuation funds.

7.1.3 Funds and Insurance Business Under Advice

Superannuation funds under management have been taken from APRA statistics with some adjustment to allow for SMSF's and other items. These have been broken down to determine the amounts that are under advice by financial advisers.

Current volumes of managed investment business have been taken from statistics provided by wealth managers and from Plan for Life. It has been assumed that 44% of this business is under advice by a financial adviser. The 44% assumption is based on published dealer group funds under advice statistics across superannuation and managed investments. This total amount, less superannuation funds under advice, gives an estimate of managed investment business under advice.

Current risk insurance annual premiums under advice are taken from insurance company and superannuation fund statistics.

A summary of current business volumes under advice is set out in Table 3.

Table 3. Business Under Advice at 30 June 20011

Business	Volume at 30 June 2011 $M
Superannuation FUA	243,610
Managed Investments FUA	131,548
Total Investment Business	375,158
Risk Insurance APIUA	6,570

Note: FUA is funds under advice, APIUA is annual premium income under advice

7.1.4 Current Commission Rates

We have estimated current average, initial and trail commission rates for each type of product based on our knowledge of various financial institutions in each of the various market segments. These assumptions are set out in Appendix A (Commission and Fee Rates).

For risk insurance business, published new business figures are not a good guide to the amount of business upon which commission is paid. In particular:

- Around 42% of reported new business represents premium increases due to increased age and indexation of sums insured. In general, no upfront commission is paid on such increases[8].
- Some 'new business' represents customers moving from employer superannuation to retail products on changing employer. Up front commission is rarely paid on such business.
- Some business under products designed for adviser distribution is sold direct rather than via an adviser.

Overall, we have assumed that, for the 58% of reported new business that is not a captive increase though age and CPI indexation, the average rate of up front commission is 80% of the annual premium. This is equivalent to a rate of 110% on 73% of such business.

7.1.5 Number of People Obtaining Financial Advice

Statistics from ASIC suggest that around 1,800,000 people have received advice from a financial adviser at some time[9]. This represents 10% of the population aged over 15, or 16% of the working population aged over 15. This relationship is reasonable relative to other industry commentary about adviser penetration.

Feedback from a number of dealer groups suggests that, on average, only 15% to 20% of advisers' clients receive active ongoing advice. Typically, these are deemed to be the 'high value' clients.

We have therefore assumed that 15% of the 1,800,000 people receive financial advice on an annual basis and the remaining 85% receive advice every 3.2[10] years. This leads to an assumed number of pieces of advice being 752,675 per annum, across all forms of advice and all types of advice remuneration.

8 A few companies pay up front commission on CPI increases but this is generally balanced by lower commission on 'real' new business. These have therefore been ignored.

9 Source: *ASIC Annual Report 2009-2010*. ASIC did not publish a corresponding figure for 2010-2011 but market feedback suggests that the number has been fairly stable between the two years.

10 The March 2010 report assumed advice in received one every 4.8 years. The lower figure assumed in this report reflects the increased volume of scaled advice already being provided in the market and more frequent advice being provided generally.

8. Advice Market Model Before Regulatory Change

Our approach to developing the model of the advice market, ignoring potential regulatory changes, is set out below.

8.1 Population Model

We have developed a model of the Australian population projected out for the next 15 years. We use this model across a range of research activities, including our superannuation market projections report and risk insurance market report. It allows for population growth through births and immigration, offset by deaths and emigration and is calibrated to the ABS population model[11].

The Rice Warner population model breaks the overall population down into those with superannuation accounts and those without. Those without superannuation accounts will include the following groups of people, unless they have a superannuation account as a result of a previous period of employment:

- unemployed people
- non-working spouses
- those earning less than $450 per week
- those too young to work.

The model is broken down into the various segments of the superannuation market:

- Industry funds
- Public sector funds
- Corporate funds
- Employer master trusts
- Retail superannuation
- ERFs and RSAs
- SMSF's.

Furthermore it identifies those within each market segment who have risk insurance. For this purpose the market segments are:

- Industry funds
- Public sector funds
- Corporate funds
- Employer master trusts
- Adviser sold superannuation
- Adviser sold non-superannuation
- Direct.

[11] *Population Projections, Australia, 2006-2101, ABS catalogue number 3222.0, Medium Series.*

8.2 Number of People Given Advice

For the adviser market projection model, we have broken down the population model further, between those who have received financial advice in relation to superannuation, managed investments or risk insurance and those who have not.

The breakdown is based on a starting population of those who have received advice as described in Section 7.1.5 (Number of People Obtaining Financial Advice) and projected future numbers reflecting the growth in retail superannuation, managed investments or risk insurance over and above investment growth and contribution flows.

This approach is consistent with past experience where access to retail products has primarily been through advisers (or accountants).

8.3 Business Projections

Projected superannuation, managed investments and risk insurance business volumes have been determined based on assumed:

- population movements, as described in Section 8.1 (Population Model)
- superannuation contribution and withdrawal rates
- investment inflows to and outflows from managed investments
- investment returns
- fee and insurance premium deductions
- tax.

These assumptions are consistent with those in the *Rice Warner Superannuation Projections Report 2011* and *Risk Insurance Projections Report 2011.*

The managed investments model assumes investment flows of 15% of funds under advice and outflows of 12.5% of funds under advice each year.

8.4 Projected Adviser Numbers

We have assumed that the number of financial advisers operating actively in the Australian market grows in future as the number of people obtaining advice increases (see Section 8.1 Population Model).

The number of people obtaining advice reflects growth in superannuation, managed investments or risk insurance over and above investment growth and contribution flows.

8.5 Projected Commission and Fees

We have determined the amount of commission and fees paid across the various segments of the market by applying the commission rates described in Section 7.1.4 (Current Commission Rates) and Appendix A (Commission and Fee Rates) to new and in force business as appropriate.

9. Advice Market Model after Regulatory Change

9.1 Population Model

The same population model has been used as for before regulatory change.

9.2 Number of People Given Advice

To determine the overall number of people requiring advice we have started from the overall Australian population aged 15 and over, projected into the future based on ABS projections[12].

From these figure we have eliminated:

- those who are unemployed (including children)
- those earning less than $40,000 per annum.

This approach is not to suggest that those earning less than $40,000 per annum will not seek financial advice. Some do seek advice and will continue to do so. However, the provision of financial advice is skewed towards higher income earners and assumptions adopted have been designed ensure that projected levels of advice change with anticipated changes in income across the population, as determined from ABS projections.

We have split remaining people into earnings brackets and assumed that varying proportions of people will seek fee based advice (either full or scaled) depending on:

- their earnings
- the calendar year concerned, with scaled advice models becoming more prevalent as the years go by.

We have assumed the number of people receiving advice in the 12 months to 30 June 2012 is the same as in the 'before regulatory change' scenario (see Sections 8.2 Number of People Given Advice and Section 7.1.5 Number of People Obtaining Financial Advice).

However, we have broken this down into earnings categories as set out in Table 4.

Table 4. Proportion of people given advice in the 12 months to 30 June 2012

Earnings	Comprehensive	Less Complex	Scaled
	(%)		
< $53,000	0.0	0.0	0.0
$53,000 to $66,000	3.0	7.0	3.5
$66,001 to $86,000	4.5	10.5	3.5
> $86,000	6.0	14.0	3.5

These assumptions are consistent with feedback from dealer groups which suggests that advice is focused on higher wealth individuals. Higher wealth broadly equates to higher income.

[12] *Population Projections, Australia, 2006-2101, ABS catalogue number 3222.0, Median Series.*

The assumption for scaled advice reflects feedback from superannuation funds and their advice service providers. The take-up of scaled advice has increased over the past two years but off a low base.

The assumptions in Table 4 mean that the total number of pieces of advice provided in 2012 is 752,675, as stated in Section 7.1.5 (Number of People Obtaining Financial Advice).

Assumptions regarding the future take-up of advice in the 12 months to 30 June 2013, after the regulatory change, vary by income category. The assumptions for 2011 and 2023 are set out in Table 5. In the intervening years there is assumed to be a gradual increase in scaled advice, from the 2012 levels to the 2023 levels.

Table 5. Future Take-up of Advice in 12 Months to 30 June 2013 and 30 June 2027

Earnings[13]	Proportion of people given advice in					
	2013			2026		
	Comprehensive	Less Complex	Scaled	Comprehensive	Less Complex	Scaled
	(%)					
< 40,000	0.0	0.0	0.0	0.0	0.0	0.0
$40,000 to $53,000	0.0	0.0	1.0	0.0	0.0	15.0
$53,001 to $66,000	3.0	7.0	4.5	3.0	7.0	18.5
$66,001 to $86,000	4.5	10.5	4.5	4.5	10.5	18.5
> $86,000	6.0	14.0	4.5	6.0	14.0	18.5

Average fees have been assumed to be $2,550 across comprehensive advice and less complex advice and $275 for scaled advice.

The methodology stated above is clearly approximate. In reality:

- some people on relatively low earnings will require and obtain full financial advice; and on the other hand
- some people earning more than $86,000 per annum will have relatively simple financial circumstances, leading them to obtain only scaled advice or none at all.

However, it is appropriate to use the figures stated in Table 5 as averages across the market.

The take-up of advice stated in Table 5 has been determined by considering both the demand for advice and the supply of advice.

In addition, we have assumed continuation of existing commission arrangements for risk insurance business with the exception that commission on group superannuation risk insurance business will cease for new arrangements from 1 July 2013, subject to grandfathering of existing arrangements up until the full transfer of default arrangements to MySuper on 1 July 2017.

[13] In 2011 dollars.

9.2.1 Demand for Advice

The demand for full advice (defined to include both comprehensive and less complex advice) is assumed to be broadly unchanged after the regulatory change. This is because clients who are currently serviced actively by their advisers are likely to continue to use their adviser after the regulatory change. There is the possibility that demand for full service advice could increase in response to the reforms depending on the effectiveness of commercial strategies which seek to convert scaled advice clients to full advice clients.

On the whole, fees will be lower than the equivalent commission paid before the change and advisers will be adept at demonstrating the value they add to this group of clients.

Some of these clients may decide to forgo advice once explicit fees are charged but some others who currently distrust the commission regime may decide to seek comprehensive or less complex advice once fee based advice becomes more commonly available. We have assumed that these two groups will be of broadly equal size so they will have no net impact on the overall numbers of people receiving advice.

As stated in Table 5, it is assumed that in the 12 months to 30 June 2013 (the first year after the regulatory change) 3% of those earning more than $53,000 per annum (and 1% of those earning between $40,000 and $53,000 per annum) will obtain scaled advice. This represents a 42% increase on the level of scaled advice assumed in the 12 months to 30 June 2011. The key drivers of this increase are the assumed increase in the supply of advice, as discussed in Section 9.2.2 (Supply of Advice) and increased consumer awareness that the cost of advice is more transparent following the FoFA changes.

9.2.2 Supply of Advice

Many superannuation funds have established scaled advice services for their members. These are in addition to general advice services which fall outside the scope this report. We estimate that there is currently the equivalent of around 300 people whose primary focus is on the provision of scaled advice across the market.

Note that, in practice, many advisers in the broader market provide the full range of advice services, ranging from scaled advice at the one extreme to comprehensive advice at the other. However, for easy of classification, these have been included as 'full advisers'.

Scaled advisers are employed by specialist providers such as IFFP, Money Solutions and QInvest, banks and wealth managers such as ANZ, CBA and AMP and superannuation funds such as Sunsuper and GESB.

In most cases, scaled advice services are not currently marketed actively. Funds respond to in-bound requests for advice rather than pro-actively offering advice to members via marketing and out-bound campaigns. Some funds provide scaled advice (as well as general advice) 'free' with the cost being met from administration fees and they would certainly be swamped with work if they were to market the service actively.

From the discussion above, it can be seen that, in the current environment, the provision of scaled advice is driven more by the supply (or lack of supply) of advice services rather than the demand for them.

An increasing number of funds are reviewing their member engagement and advice strategies and, as a result, are developing larger scaled advice platforms and out-bound communication strategies, in some cases supported by sophisticated analysis of member data, to encourage members to obtain advice.

This is partly driven by the desire for members to adopt a robust retirement and protection strategy and partly by the desire to encourage members to seek advice from the fund itself rather than from elsewhere, leading to the risk that they will be lost to another fund.

In addition, we expect that an increasing number of accountants will diversify into financial advice business, drive in part by the new requirements for them to be licensed to provide advice on establishing SMSFs. This will result in an increasing flow of financial professionals into the financial advice market. We also expect much of the advice provided by these accountants to be scaled advice.

The latent demand for advice will only be satisfied as the supply of advice increases. Thus, based on our knowledge of the advice strategies of the major superannuation funds, we have assumed that each year an additional 1% of superannuation fund members will become aware that scaled advice is available, will respond to the offer of advice and will be provided with advice from one of a team of advisers who are sufficient in number to meet the overall demand.

On this basis, funds and wealth managers will need to employ between 130 and 150 additional advisers each year. We believe this is the maximum rate at which appropriately skilled advisers can be recruited, trained and provided with necessary support such as membership analytics.

9.2.3 Demand Elasticity for Financial Advice

The likely demand response to the broader availability of low cost financial advice could also be estimated using information on the price elasticity for financial advice products. While there is no readily available public information on the price elasticity for financial advice in Australia, the March 2010 report provided details of an analysis of a large industry superannuation fund which we used to assess the price elasticity[14] of demand for financial advice across a range of price points. This varied from 0.5 to 1.7 with a midpoint price elasticity around 0.9.

As expected, advice services exhibit non-linear demand curves with price elasticity increasing as the asking price consumes an ever greater share of respondent's disposable income.

With a midpoint elasticity around 1.0, any change in price will elicit roughly the same (but opposite) proportionate change in demand.

The pricing of existing full service financial advice is situated at the elastic end of the demand curve with a price point elasticity of 1.5 at $3,600. With price elasticity around this level, offering a better value product could yield a significant increase in demand.

The assumptions used in this report result in a weighted average cost of advice for superannuation and managed investing of $2,135 in 2011/2012 ($2,550 for full advice and $275 for scaled). After the regulatory change the weighted average cost of advice falls to $1,188 by 2025/2026 (driven mainly by the increase in demand for scaled advice relative to full advice)[15].

Compared to the pre regulatory change scenario demand increases from 753,000 pieces of advice to 1,769,000 pieces of advice. These outcomes are consistent with an elasticity of around 1.31 (using the average change in demand and price). This compares favourably with the industry fund research referred to above which suggests an elasticity of 1.29 between similar price points.

14 Increase in demand as a proportion of the reduction in price or reduction in demand as a proportion of the increase in price.

15 All fees are expressed in 2011 dollars.

9.3 Business Projections

The same business projections model has been used 'after regulatory change' as 'before regulatory change'.

In addition, we have assumed that:

- The savings in commission and fee payments by clients will be used to boost their investments.
- The increase in the amount of advice provided will lead to an increase in superannuation and investment contributions. We have assumed that contributions increase by 5% of the rate of increase in the number of pieces of advice provided. For example, if 10% more pieces of advice are provided, then contributions increase by 0.5%, over and above any increase that would otherwise have occurred. The rationale for this assumption is that where advice is provided on topics such as superannuation adequacy or co-contributions, the result will be that at least in some cases higher future contributions will be made.

9.4 Projected Adviser Numbers

We have determined the number of financial advisers after the regulatory change based on the demand for financial advice across the community (as described in Section 8.2 Number of People Given Advice). To some extent this also reflects the pace of development of advice models to meet that demand.

Given the grandfathering arrangements under the 'after regulatory change' scenario, any change in the profile of the financial advice market will inevitably be gradual.

We anticipate that those individuals who do not require full financial advice are unlikely to pay advice fees at the levels likely to be required for financial advice businesses to be viable. However, these will mainly be people who are not actively serviced by their financial adviser currently, so the demand for full advice from current clients of financial advisers is unlikely to fall substantially after the regulatory change. Our detailed assumptions in this regard are set out in Section 9.2 (Number of People Given Advice).

On the other hand, the need for scaled advice, such as the level of contributions required to meet a superannuation fund member's desired retirement income, or the level of insurance cover required given relatively straightforward personal and family circumstances, will increase.

We anticipate that such members will seek advice from scaled advisers employed by superannuation funds, banks and other wealth manager. However, scaled advice models are still in their infancy across the industry and marketing of such services is patchy at best. We would anticipate scaled advice being provided for a cost of around $275, compared with an average price of $2,550 for full financial advice. Therefore, initially the infrastructure will not exist to ensure that all those who need scaled advice will receive it.

Ultimately, we anticipate that, after the regulatory change, 1,095,000 pieces of financial advice will be provided in 2016 compared with 784,000 if the change did not take place, driven by:

- The further development of advice models by superannuation funds and wealth managers leading to better access by members to scaled advice.
- Increased sales to bank customers based on sophisticated data-mining and customer segmentation.
- Data mining of superannuation member bases to improved knowledge of needs and target advice accordingly.

9.5 Projected Commission and Fees

We have determined the amount of commission and fees paid across the various segments of the market by applying the commission and fee rates described in Section 7.1.4 (Current Commission Rates) and Appendix A (Commission and Fee Rates) to new and in force business and as advice is assumed to be given.

As discussed in Section 8.2 (Number of People Given Advice), different groups of people have been assumed to obtain different levels of advice.

From 1 July 2012 we have projected business volumes separately in respect of:

- Pre 2012 arrangements, covered by grandfathering and therefore subject to existing adviser remuneration terms.
- Post 2012 arrangement where the client has opted in for ongoing advice and asset based fees are therefore paid.
- Post 2012 arrangement where the client has not opted in for ongoing advice and asset based fees are therefore not paid.

The rate of opt in for ongoing advice has been assumed to be 80% at each opt-in date (which occurs every two years).

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10. Projection Results

Table 6 sets out projected commission and fee payments over the next 15 years on the assumption that there is no change in the current regulatory environment.

Table 6. Adviser Market BEFORE Regulatory Change – in Future Dollars

12 Months to 30 June	Commission and Fees			Total	Average payment per Adviser
	Superannuation Business	Managed Investments	Risk Insurance		
	($M)				($'000)
2012	1,193	796	1,313	3,302	188
2013	1,262	879	1,428	3,569	202
2014	1,338	970	1,552	3,860	217
2015	1,420	1,071	1,684	4,175	233
2016	1,511	1,182	1,825	4,518	250
2017	1,609	1,305	1,977	4,890	269
2018	1,714	1,439	2,138	5,292	289
2019	1,828	1,588	2,310	5,726	310
2020	1,949	1,751	2,478	6,178	333
2021	2,073	1,931	2,656	6,660	357
2022	2,205	2,129	2,847	7,181	384
2023	2,346	2,347	3,052	7,745	412
2024	2,496	2,587	3,269	8,352	443
2025	2,654	2,851	3,501	9,007	476
2026	2,820	3,143	3,747	9,709	511

Note: Average payment per adviser is calculated with the number of adviser at the beginning of the year.

Table 7 shows the same information expressed in 2011 dollars.

Table 7. Adviser Market BEFORE Regulatory Change – in 2011 Dollars

12 Months to 30 June	Commission and Fees			Total	Average payment per Adviser
	Superannuation Business	Managed Investments	Risk Insurance		
	($M)				($'000)
2012	1,158	773	1,275	3,206	182
2013	1,190	829	1,346	3,364	190
2014	1,224	888	1,420	3,533	198
2015	1,261	952	1,496	3,709	207
2016	1,303	1,020	1,574	3,897	216
2017	1,347	1,093	1,655	4,095	225
2018	1,394	1,170	1,738	4,302	235
2019	1,443	1,253	1,824	4,520	245
2020	1,494	1,342	1,899	4,735	255
2021	1,542	1,437	1,977	4,956	266
2022	1,593	1,538	2,056	5,188	277
2023	1,646	1,646	2,140	5,432	289
2024	1,700	1,762	2,226	5,687	302
2025	1,755	1,885	2,315	5,955	315
2026	1,810	2,017	2,405	6,232	328

Note: Average payment per adviser is calculated with the number of adviser at the beginning of the year.

Table 8 shows the total commission and fees and advisers as Table 6 but also shows the volumes of business each year, broken down between superannuation, managed investments and risk insurance business.

Table 8. Business Volumes BEFORE Regulatory Change – in Future Dollars

12 Months to 30 June	Business Volume			
	Superannuation Business	Managed Investments	Total Investment Business	Risk Insurance
	FUA in $M			APIUA in $M
2012	257,643	131,548	389,191	6,570
2013	273,206	145,232	418,439	7,145
2014	290,529	160,320	450,849	7,763
2015	309,794	176,948	486,742	8,423
2016	331,198	195,268	526,466	9,125
2017	354,810	215,448	570,258	9,883
2018	380,809	237,669	618,478	10,687
2019	409,206	262,136	671,342	11,548
2020	439,826	289,079	728,905	12,381
2021	472,750	318,741	791,491	13,272
2022	508,235	351,396	859,631	14,220
2023	545,917	387,349	933,266	15,243
2024	586,159	426,942	1,013,101	16,325
2025	628,696	470,546	1,099,242	17,486
2026	672,803	518,611	1,191,415	18,709

Note: FUA is funds under advice, APIUA is annual premium income under advice.

To place these figures in context, the total commission and fees paid in the 12 months to 30 June 2012 ($3.3 billion) are anticipated to represent 0.25% of GDP.

Tables 9, 10 and 11 set out corresponding information to Tables 6, 7 and 8 but assume that the regulatory changes set out in Section 2 (The FoFA and Related Regulatory Changes) occur.

Table 9. Adviser Market AFTER Regulatory Change – in Future Dollars

12 Months to 30 June	Commission and Fees			Average payment per Adviser p.a.
	PRE 2012 arrangements	POST 2012 arrangements	Total	
	($M)			($'000)
2012	3,302	0	3,302	188
2013	1,755	2,540	4,295	243
2014	1,577	2,912	4,489	209
2015	1,235	3,281	4,516	207
2016	885	3,637	4,522	212
2017	541	3,984	4,525	227
2018	230	4,321	4,551	243
2019	122	4,653	4,775	271
2020	99	4,980	5,079	294
2021	80	5,318	5,398	313
2022	65	5,668	5,734	334
2023	53	6,035	6,088	357
2024	43	6,416	6,460	380
2025	35	6,816	6,851	405
2026	29	7,231	7,260	431

Note: Average payment per adviser is calculated with the number of adviser at the beginning of the year.

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Table 10. Adviser Market AFTER Regulatory Change – in 2011 Dollars

12 Months to 30June	Commission and Fees			Average payment per Adviser p.a.
	PRE 2012 arrangements	POST 2012 arrangements	Total	
	($M)			($'000)
2012	3,206	0	3,206	182
2013	1,654	2,394	4,048	229
2014	1,443	2,665	4,108	191
2015	1,097	2,915	4,012	184
2016	763	3,137	3,901	183
2017	453	3,336	3,789	190
2018	187	3,513	3,701	198
2019	97	3,673	3,770	214
2020	76	3,817	3,892	225
2021	60	3,957	4,017	233
2022	47	4,095	4,142	242
2023	37	4,233	4,270	250
2024	29	4,369	4,399	259
2025	23	4,506	4,529	268
2026	18	4,641	4,660	260

Note: Average payment per adviser is calculated with the number of adviser at the beginning of the year.

The total commission and fees in Tables 9 and 10 can be compared with the total commission and fees in Tables 6 and 7. However, the breakdown of commissions by type of product in Tables 6 and 7 is not available after the regulatory change (Tables 9 and 10) because fee based advice may be related to a combination of products – the fee is separate from the product.

Table 11. Business Volumes AFTER Regulatory Change – in Future Dollars

12 Months to 30 June	Business Volume			
	Superannuation Business	Managed Investments	Total Investment Business	Risk Insurance
	FUA in $M			APIUA in $M
2012	257,643	131,548	389,191	6,570
2013	272,662	146,570	419,232	7,145
2014	291,608	182,980	474,588	7,763
2015	311,823	207,264	519,086	8,423
2016	334,542	229,143	563,685	9,125
2017	359,898	247,102	607,000	9,883
2018	388,156	259,357	647,513	10,687
2019	419,256	281,491	700,747	11,548
2020	453,001	314,127	767,128	12,381
2021	489,523	350,528	840,051	13,272
2022	529,121	391,095	920,216	14,220
2023	571,469	436,315	1,007,784	15,243
2024	617,000	486,723	1,103,722	16,325
2025	665,489	542,917	1,208,406	17,486
2026	716,224	605,619	1,321,843	18,709

Note: FUA is funds under advice, APIUA is annual premium income under advice.

Comparing Tables 6 to 9, we estimate that the key impacts of the regulatory change will be as follows:

- Total adviser remuneration will be broadly unchanged in the fourth year after the introduction of the new regulations (i.e. the year to 30 June 2016) and reduce by $1 billion in the 10th year after the change (in 2011 dollars). This includes fee income for the provision of scale advice.
- A bring forward of fee revenue associated with a movement towards fee for service charging is likely to result in a short term boost to the overall number of advisers operating in the market until 2017. However, as the bring-forward of revenue unwinds, total adviser employment will settle such that it will be broadly similar to the levels before the reform commenced (reducing by 5% over the period to 30 June 2026). While the number of full service advisers will decline from around 17,300 to around 14,300 in 2026 this will be offset by an additional 2,200 advisers providing scaled advice to clients/fund members as the provision of such advice becomes more accessible and grows to meet the demand for such advice. Over the long term the total level of adviser employment will be sensitive to the success of commercial strategies developed in response to the reforms.
- Total commission and fees paid increase slightly from 0.25% of GDP (or $3.3bn) in 2011/2012 to 0.25% of GDP (or $7.3bn) in 2025/2026. If the regulatory change does not occur, total commission and fees paid will increase to 0.34% of GDP ($9.7bn) in 2025/2026. The reduction in commissions and fees if the regulatory change occurs would flow directly into increased superannuation and other savings by individuals. It would also have secondary impacts on the economy through a diversion of adviser payments to private savings. We have not attempted to quantify these impacts.

The impact of the assumed regulatory change is clearly dampened by:

- the ‘grandfathering’ provisions which enable trail commission to be paid on business already under advice at the date of change
- the exclusion of risk insurance from the conflicted remuneration rules.

However, in the short term the change to fees for service also has a dampening impact. This is because up front commissions on superannuation and investment business are often less than the advice fees likely to be charged instead. For example, if a client makes superannuation contributions of $100,000 per annum and the adviser charges 2% up front commission on each contribution, then the first year commission is $2,000. Under an advice fee regime, the adviser may charge $2,550 up front. In this example, adviser remuneration in the short term has increased.

Whilst the changes in overall adviser numbers are discussed above, the mix of advisers is likely to change significantly. The type of adviser required to meet consumer demand in a fee for service environment will differ from traditional full service advisers. More scaled advice (including single issue and intra-fund advice) will be provided, particularly by salaried advisers in superannuation funds and wealth managers. The skills required for this work will be different, for example:

- the advice process will be more automated, given its more limited scope
- more will be provided by telephone rather than face to face
- prospecting for new customers is likely to be limited to in-bound telephone call response and out-bound call campaigns rather than identifying leads and broad marketing activities
- remuneration structures are clearly very different with rewards for scaled advisers (as defined in Section 3 Terminology) being a fixed salary and possibly a bonus depending on quality of work as opposed to sales and retention.

These differences are likely to lead to different people entering advice jobs and some existing financial advisers leaving theirs.

Tables 12 and 13 show an estimated breakdown of advisers between full service advisers and scaled advisers and the pieces of advice they provide, before and after the regulatory change respectively. This breakdown is indicative only. In reality, many full advisers will provide both full service and scaled advice and some scaled advisers provide full advice.

Table 12. Number of Advisers BEFORE Regulatory Change

30 June	Number of Advisers Giving Full Advice	Number of Advisers Giving only Scaled Advice	Total Advisers	Number of piece of Full Advice	Number of piece of Scaled Advice	Total piece of Advice
2011	17,300	300	17,600	615,221	137,455	752,675
2012	17,407	304	17,711	618,868	139,287	758,155
2013	17,508	308	17,816	622,967	141,120	764,087
2014	17,621	313	17,934	627,066	143,411	770,477
2015	17,734	318	18,052	631,512	145,702	777,214
2016	17,857	323	18,180	636,132	147,993	784,125
2017	17,985	328	18,313	640,648	150,284	790,932
2018	18,110	333	18,443	645,164	152,575	797,738
2019	18,235	338	18,573	647,804	154,865	802,669
2020	18,306	343	18,649	649,957	157,156	807,114
2021	18,363	348	18,711	652,215	159,447	811,663
2022	18,422	354	18,776	654,647	162,196	816,843
2023	18,486	360	18,846	656,974	164,945	821,920
2024	18,548	365	18,913	659,371	167,236	826,607
2025	18,612	370	18,982	661,420	169,527	830,948
2026	18,666	375	19,041	n/a	n/a	n/a

Note: The numbers of pieces of advice shown in the table above are the numbers of pieces of advice provided in the 12 months following the relevant 30 June dates.

Table 13. Number of Advisers AFTER Regulatory Change

30 June	Number of Advisers Giving Full Advice	Number of Advisers Giving only Scaled Advice	Total	Number of piece of Full Advice	Number of piece of Scaled Advice	Total piece of Advice
2011	17,300	300	17,600	615,221	137,455	752,675
2012	17,407	304	17,711	622,565	139,373	761,938
2013	20,929	560	21,489	629,919	256,526	886,445
2014	21,087	692	21,779	637,249	317,280	954,529
2015	20,500	828	21,328	644,662	379,425	1,024,086
2016	19,000	966	19,966	651,873	442,749	1,094,623
2017	17,590	1,107	18,697	658,886	507,199	1,166,086
2018	16,367	1,250	17,617	665,676	572,667	1,238,344
2019	15,908	1,395	17,303	672,422	639,284	1,311,706
2020	15,684	1,543	17,227	679,228	707,107	1,386,335
2021	15,457	1,693	17,150	685,708	775,810	1,461,517
2022	15,223	1,845	17,068	691,990	845,405	1,537,395
2023	14,991	1,999	16,990	698,057	915,837	1,613,894
2024	14,753	2,154	16,907	703,941	987,099	1,691,040
2025	14,515	2,312	16,827	709,714	1,059,245	1,768,959
2026	14,269	2,471	16,740	n/a	n/a	n/a

Note: The numbers of pieces of advice shown in the table above are the numbers of pieces of advice provided in the 12 months following the relevant 30 June dates.

11. Sensitivities

We have tested the impact of changes to our assumptions on the outcome across the financial advice market. Table 14 shows the impact of changes in various assumptions on:

- total commission and fees (in future dollars)
- total piece of advice
- numbers of financial advisers.

Table 14. Sensitivities

Scenario	The 2nd Year (2013/14)			The 5th Year (2016/17)			The 10th Year (2021/22)		
	Total Commission and Fees $M	Total piece of Advice	Number of Advisers (end of year)	Total Commission and Fees $M	Total piece of Advice	Number of Advisers (end of year)	Total Commission and Fees $M	Total piece of Advice	Number of Advisers (end of year)
AFTER Regulatory Change:									
Base assumptions (see Section 7 above)	4,489	886,445	21,779	4,525	1,094,623	18,697	5,734	1,461,517	17,068
Advise fees 20% lower, usage of both full and scaled financial advice 20% higher	4,321	1,063,734	20,964	4,244	1,313,547	17,551	5,624	1,753,821	16,721
Advise fees 20% higher, usage of both full and scaled financial advice 20% lower	4,527	709,156	21,944	4,712	875,698	19,427	5,627	1,169,214	16,728
20% less usage of scaled financial advice in all years	4,442	835,140	21,488	4,476	1,006,073	18,394	5,673	1,306,355	16,690
20% less usage of full financial advice in all years	4,291	760,461	20,831	4,444	964,248	18,375	5,254	1,324,376	15,725
20% less usage of both full and scaled financial advice in all years	4,235	709,156	20,495	4,372	875,698	17,975	5,193	1,169,214	15,346
20% more usage of scaled financial advice in all years	4,534	937,750	22,062	4,572	1,183,172	18,996	5,794	1,616,679	17,447
20% more usage of full financial advice in all years	4,717	1,012,429	22,865	4,714	1,224,997	19,458	6,209	1,598,659	18,397
20% more usage of both full and scaled financial advice in all years	4,756	1,063,734	23,118	4,750	1,313,547	19,708	6,270	1,753,821	18,774
50% more new clients choosing to opt-in	4,531	886,445	21,979	4,617	1,094,623	19,066	5,899	1,461,517	17,528

Appendix A Commission and Fee Rates

Table 15 sets out assumed average rates of commission (including rebates and volume overrides) and fees.

Table 15. Commission and Fee Assumptions

Commission type	Business type	Amount[16]
Upfront commission rate	Investment (as % of FUA)	2.0%
	Risk Insurance (as % of new premiums)	110%*
Trail commission rate	Investment (as % of FUA)	0.35% per annum
	Risk Insurance (as % of premiums in force)	10%
Upfront fee paid	Full advice (per advice)	$2,550
	Scaled advice (per advice)	$275
Asset Based Fee paid	Full advice (subject to opt in)	0.175% per annum, reflecting the assumption that 50% of new clients opt for ongoing advice and pay 0.35% per annum.

* Under the 'before change' scenario, this rate of commission is assumed to be paid on 72.7% of retail risk insurance business, excluding direct risk insurance.

It has been assumed that, after the regulatory change, 5% of new risk insurance business is sold on a fee for service basis with the average fee being $1,500.

16 All dollar amounts are in 2011 dollars.