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Transformation of the Financial Advice Industry

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This report constitutes a Statement of Advice as defined under the Financial Services Reform Act. It is provided by Rice Warner Actuaries Pty Ltd. which holds Australian Financial Services Licence number 239 191.

1. Executive Summary

1.1 Our Brief

Rice Warner Actuaries has been engaged by David Whiteley and Matthew Steen of Industry Super Network to estimate the impact of potential regulatory changes in the financial advice industry. We have been asked to model the impact of any potential ban on commissions on the industry itself and on the broader economy.

Specifically we have been asked to model:

- Projected commission and fee flows to financial advisers into the future as if there were no change to the existing regulatory framework. This is to be the “base scenario” against which alternative scenarios are to be compared, as described below;
- Corresponding projections assuming the following changes:
 - Changes apply only to new business written after the change, in other words existing business is “grandfathered”;
 - Changes may apply only for superannuation and investment business or for risk insurance business as well;
 - All payments from product providers to advisers would be banned. This includes commissions, volume bonuses and fund manager rebates;
 - Advisers would have a fiduciary duty to place their clients’ interests ahead of their own; and
 - Fees could be charged directly to the adviser’s clients, but could only be charged where specific advice is provided and not on an ongoing contractual basis. So neither trail commission nor asset based fees would be permitted unless specific ongoing advice is provided and the client agrees to pay for the adviser in this manner.

It should be noted that this report does not recommend changes to the legislative or regulatory environment affecting the provision of Financial Advice. It simply provides our views on the outcome if the particular regulatory changes set out above were to occur.

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

The price of advice is consequently non-transparent to retail clients (customers). While low or minimal upfront dollar components can make the cost seem reasonable to non-sophisticated customers, these are usually supplemented by structures that include ongoing asset-based fees. These have a dramatic impact on retirement savings over the long term. Another feature of this fee structure is that inertia or disengagement on the part of many customers means that revenue is drawn from those who may not have received advice for many years.

Reform to the superannuation and wealth management industry is likely to involve a shift away from a remuneration model for financial advice based on commissions and asset-based fees.

Instead, we expect that remuneration for comprehensive advice will increasingly be based on fee for service or time-based fees. These may be deducted from clients' accounts in a single upfront payment, or in instalments over several periods.

On average, the price of financial advice is expected to be lower. However, increased transparency may result in a perception of higher cost, potentially resulting in reduced demand for comprehensive advice. This report considers the implications for reform in detail.

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 simple advice delivered periodically throughout a member's lifetime. However, we expect the number of Australians taking advantage of simple 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.

1.2.2 Advice as a Growth Industry

The superannuation industry will grow substantially over the next fifteen years with assets expected to increase by 9.6% per annum. 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.

1.2.3 The Growth of Simple Advice

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

- 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. Some of these people will turn to their superannuation funds where simple advice can be provided more 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 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 simple advice will increase substantially, to the point where **one in thirteen people** across the overall population or **one in seven employed people** will obtain regulated financial advice each year.

There are many factors which will impact on the demand for a holistic advice service. We expect there will be a higher demand from the increasing number of wealthy people who will require personal advice for their complex financial affairs.

Conversely, we know that the average age of experienced financial planners is above age 50. As the older cohort of advisers retires, there will be a decline in the number of advisers. The shortfall will be filled as the bigger dealer groups recruit and train new advisers. However, the industry does not have the capacity to train more than the replacement level - particularly if resources are devoted to single issue advice.

Those currently receiving full advice are likely to pay the same or less in fees after the regulatory change than they do currently and most will see the value of the advice provided, even when the cost is transparent.

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. We believe that these two groups will be broadly equal in size.

The growth in single issue advice will come from two main sources, namely industry fund members and bank customers.

1.2.5 Impact of Change on Industry Employment and Productivity

The grandfathering of existing business means that any change to the financial advice industry will be gradual.

For superannuation and investment business, a change to a fee for advice model will result in a short term boost to adviser remuneration because, a typical up front fee for comprehensive advice can be higher than an up front commission paid at present. This effect might be reduced if advice fees are paid in instalments over a period of time (say two years).

Balancing these trends, we anticipate that, with a total ban on product provider payments¹ to advisers (with grandfathering of existing business) and the introduction of fee based advice across the market, the number of **full service** financial advisers, currently around 15,400, is likely to remain broadly stable over the next 5 years and will then decline to around 8,600 in 2024. There will be an additional 3,200 advisers providing simple advice to clients/fund members as the provision of such advice becomes more accessible and grows to meet the demand for such advice.

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¹ See Section 1.1 above for a description of such payments

Within this total, the larger dealer groups will increase in importance with a number of smaller dealer groups being acquired by larger, usually institutionally owned dealer groups which can provide comprehensive back office services at costs reflecting the greater economies of scale available to them. It is likely that larger dealer groups will develop simple advice models to support their existing and prospective customers who have simple needs. Thus, they may continue to grow their adviser numbers in aggregate, but there will be a shift towards simple advice.

Our projections show similar levels of full advice being provided by a declining number of full 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. The surviving adviser practices will be those which focus on providing quality advice at a competitive price, assisted by efficiency improvements.

Table 1 over the page 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 against corresponding amounts estimated to be paid under the new regulatory scenario set out above.

The regulatory change is assumed to take place on 1st July 2010.

Table 1. Estimated Commission and Fees - in Future Dollars

12 Months to 30 th 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
2010	2,714	2,714	0	0%	174	174
2011	2,967	3,811	-844	-28%	185	234
2012	3,238	3,774	-536	-17%	199	178
2013	3,528	3,710	-181	-5%	213	188
2014	3,839	3,621	218	6%	229	199
2015	4,172	3,509	663	16%	246	210
2016	4,529	3,363	1,166	26%	264	221
2017	4,911	3,250	1,660	34%	283	234
2018	5,318	3,379	1,940	36%	304	265
2019	5,739	3,517	2,223	39%	326	280
2020	6,188	3,665	2,524	41%	350	296
2021	6,666	3,824	2,842	43%	375	312
2022	7,174	3,991	3,184	44%	403	329
2023	7,713	4,167	3,546	46%	433	346
2024	8,288	4,351	3,937	47%	465	363

Note: Average adviser payments stated in the table above are combined averages across both full and simple advice and advisers. The increase in average payments per adviser to \$234,000 in the 12 months to 30th June 2011 is because the average is based on the number of advisers at the start of each year. In 2011 there is a large increase in advisers during the year.

Table 2 over the page shows the same information as Table 1 but expressed in 2009 dollars.

Table 2. Estimated Commission and Fees - in 2009 Dollars

12 Months to 30 th 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
2010	2,635	2,635	0	0%	169	169
2011	2,797	3,592	-795	-28%	175	220
2012	2,964	3,454	-491	-17%	182	163
2013	3,135	3,296	-161	-5%	189	167
2014	3,312	3,123	188	6%	197	171
2015	3,494	2,939	556	16%	206	176
2016	3,683	2,735	948	26%	214	180
2017	3,876	2,566	1,311	34%	224	185
2018	4,076	2,589	1,487	36%	233	203
2019	4,271	2,617	1,654	39%	242	209
2020	4,471	2,648	1,823	41%	253	214
2021	4,675	2,682	1,993	43%	263	219
2022	4,885	2,718	2,168	44%	274	224
2023	5,099	2,755	2,344	46%	286	228
2024	5,320	2,793	2,527	47%	298	233

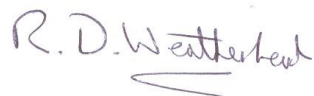
Note: Average adviser payments stated in the table above are combined averages across both full and simple advice and advisers. The increase in average payments per adviser to \$220,000 in the 12 months to 30th June 2011 is because the average is based on the number of advisers at the start of each year. In 2011, there is a large increase in advisers during the year.

After the change in the regulatory environment:

- There will a net increase in the amount of advice provided. By 2015, 300,000 additional pieces of advice will be provided and by 2024, 900,000 additional pieces of advice will be provided;
- The introduction of more efficient adviser delivery models for simple advice combined with productivity and efficiency improvements will lead to both simple and comprehensive advice being provided where there is demand for each. The higher overall volumes of advice will be provided through fewer advisers. Thus, the number of advisers will reduce by 23% by 2024;
- 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; and
- The reduction in overall adviser remuneration will be \$2.5bn (in 2009 dollars) in 2024 (or \$3.9bn in future dollars) representing 0.23% of GDP. 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.

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2. 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 customer 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, although in many cases such ongoing advice is not currently provided. At present, many members of retail superannuation master trusts do not receive personal advice². Rather advice is typically provided to the member's employer or former employer.

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

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

2.1 Terminology and Regulatory Change Date

Throughout this report we have used the following terms:

- **Full service financial adviser:** A financial adviser providing full financial advice, covering the client's overall financial needs. Although many of these advisers will provide one-off advice at a point in time, their normal service is to provide "holistic" advice over a period of years.

These 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. They are usually remunerated in the form of commission but a growing number charge fees for advice and some are salaried.

There is also a small group of independent advisers who are non-aligned and charge fee for service for all their advice. In terms of adviser numbers, these represent between 10% and 15% of the market.

- **Simple adviser:** An authorised representative of a superannuation fund or fund manager who provides simple, limited, single issue or intra-fund advice. Usually, simple 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.

Throughout this report, references to particular years are references to the 12 months to 30th June of that year.

All projections assume that any change in regulations takes effect from 1st July 2010. Thus figures for 2009 will be the same both before and after any assumed regulatory change.

Adviser remuneration figures (e.g. commissions and fees) 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.

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² According to McNair Ingenuity's *Annual Superannuation Survey 2008*.

2.2 Definitions

We note that the definition of “new business” for the purposes of grandfathering is interpreted differently across the market. The IFSA Super Charter talks about “new accounts” which could lead to up front commission being paid on contributions to existing accounts. For the purposes of this report, we have assumed that up front commission would be banned across the board after the regulatory change. However, the impact of adopting the alternative approach is quantified in Section 8 of the report.

We have used a number of terms in this report that are explained briefly below.

- **Commission:** A 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; or
 - **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:** A payment to an adviser by their client for the provision of advice. Fees are negotiated between the client and their adviser.
 - **Up front 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.

Note that in the “after regulatory change” scenarios set out in this report, we have assumed that ongoing asset based fees are banned, although up front fees could be spread over a number of years.

2.3 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. In the past, almost all remuneration was based around payments built into product fees as commission. These can 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, though these may still be based on the size of a client’s investment portfolio.

Commission payments from product providers to advisers remunerate them for two key activities:

- The provision of advice; and
- The procurement and retention of business.

The abolition of payments from product providers to advisers would mean that advisers would charge for their advice through fees paid directly by their clients. However, in itself, this would not prevent product manufacturers from providing other support to advisers, such as computer systems, back office support and research, provided this was not directly linked to acquisition of a client's business.

We consider that product manufacturers (including commercial superannuation funds) would adjust for this change by increasing their margin on services (administration, insurance, and investment) and use this to provide support for advisers and dealer groups, as discussed above but on a basis unrelated to specific sales.

Some of the larger institutionally owned dealer groups, for example those owned by MLC, AMP and AXA, have already announced new remuneration structures, following the finalisation of the IFS Super Charter. These will take effect on 1st July 2010 and follow the remuneration structures set out in the Charter.

A detailed description of the IFSA Super Charter is beyond the scope of this report. However, in brief, commissions will cease and be replaced by Member Advice Fees and, for Corporate Superannuation business, Plan Service Fees. 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 this fee structure can be the same as under the current commission structure. Up front fees can be negotiated with the client to be equivalent to the up front 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.

As stated in Section 1.1 above, within this report we have tested an alternative model under which fees could only be charged where specific advice is provided and not on an ongoing contractual basis. So, **under the new regulatory regime assumed for the purposes of this report, neither trail commission nor asset based fees would be permitted unless specific ongoing advice is provided and the client agrees, on an annual basis, to pay for it.**

Some superannuation funds already provide advice on this basis. For example, our 2009 Report for Industry Super Network compared financial outcomes for clients under a typical commission structure and under the fee structure of Industry Fund Financial Planning (IFFP). It showed substantially lower costs under the IFFP fee structure. Effectively, these clients had circumstances which did not require comprehensive advice delivered by payment of traditional trail commissions.

2.4 Simple Advice Models

2.4.1 Demand for simple 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 recent report by IBISWorld³ 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 simple 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; and
- How to benefit from government incentives such as co-contributions.

The growth in superannuation balances has encouraged many funds 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 simple advice will be good advice notwithstanding that a full analysis of their personal circumstances has not been done.

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); and
- 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, simple 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.

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³ Money Management 14th January 2010.

2.4.2 Delivery of Simple Advice

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

Simple 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.

Although Call Centres focus on simple advice, they are also 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 simple advice does not replace complex advice where needed but the simple advice process channels the client to the type of advice required.

2.4.3 Fee Structures

Simple advice provided through superannuation funds is usually provided on a fee for service basis, often for a fixed fee that might vary from \$250 to \$1,500 depending on the nature of the advice. A few superannuation funds provide advice “free” with the cost, in effect, being borne by all members out of the normal administration fee.

We expect the amount of simple 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:

- Develop and refine their advice business models;
- Recruit and train appropriate advisers; and
- Enhance administration systems to provide easy access member data to support the advice process.

3. The Transformation

3.1 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 meet with their adviser at least once a year. Over time, they build a trusting relationship. However, many are 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 new paradigm 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; and
- Some will continue under the new basis.

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

- Seek advice as and when required; or
- Seek no advice.

The transformation of this part of the industry will depend in part on the actions taken by these clients and their current advisers. Under the “grandfathering” arrangements assumed for the purposes of this report, we believe that few clients will seek to terminate existing commission arrangements and will continue to pay commissions and percentage based fees even if they receive no financial advice. However, many of those who are not currently serviced actively by their advisers will seek simple advice from their superannuation fund as the availability and knowledge of such services increases.

We note that many dealer groups are owned by financial institutions. The advisers who are Authorised Representatives of these dealer groups are often bound to use a specified investment platform. This provides uniformity within the group, better compliance and easier training. However, the platform will usually provide a rebate to the financial institution either directly or via the dealer group. This provides bias away from alternate investments.

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 super 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.

3.1.1 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.

We also consider it unlikely that up-front fees will be raised significantly if trail commissions cease, since the adviser will need to justify the cost against the initial service being provided.

The current lack of transparency makes it likely that many clients will not fall in this category.

3.1.2 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.

3.1.3 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.

3.2 Future Holistic 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-g geared investments;
 - Manage a farm; or
 - 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.

3.3 Impact on Different Types of Superannuation Client

The 9% 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 simple 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 do a comprehensive plan is not immediately available.

Nonetheless, simple advice can be provided to individuals and this will become the dominant channel for dealing with members.

Within the retail sector, distribution is through advisers who treat the employer as their client. Members can obtain advice but many do not receive it as they are unaware of the service (or don't require it). As 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.

4. The Size of the Current Advice Market

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

4.1.1 Number of Full Service Financial Advisers

We have assumed that the number of financial advisers in the Australian market is 15,355. This reflects statistics available from the FPA which provide adviser numbers across their membership, adjusted for non-FPA members. It should be noted that there are substantially more than 15,355 authorised representatives in the market. However, a higher proportion of them sell little or no business, so 15,355 has been adopted as a measure of what might be described as “active financial advisers”.

4.1.2 Number of Simple Advisers

In addition, the current number of salaried financial advisers giving simple advice to superannuation fund members is assumed to be 200. This includes advisers in IFFP, Money Solutions, QInvest, Mercer, Plum, Colonial First State and other superannuation providers.

4.1.3 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 available 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 FPA statistics which provide funds under advice 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 (supplemented by and reconciled to Plan for Life published statistics).

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

Table 3. Business Under Advice at 30th June 2009

Business	Volume at 30th June 2009
Superannuation FUA (\$M)	233,634
Managed Investments FUA (\$M)	116,366
Total Investment Business (\$M)	350,000
Risk Insurance APIUA (\$M)	5,548

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

4.1.4 *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.

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 up front commission is paid on such increases⁴;
- Some “new business” represents customers moving from employer superannuation to retail products on changing employer. Up front commission is rarely paid on such business; and
- Some business 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.

4.1.5 *Number of People Obtaining Financial Advice*

Statistics from ASIC suggest that around 2,000,000 people have received advice from a financial adviser at some time⁵. This represents 11% of the population aged over 15, or 19% of the working population aged over 15. This relationship is reasonable relative to other industry commentary about adviser penetration⁶.

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 2,000,000 receive financial advice on an annual basis and the remaining 85% receive advice every 4.8 years. This leads to an assumed number of pieces of advice being 654,000 per annum, across all forms of advice and all types of advice remuneration.

A recent report by IBISWorld⁷ stated that advisers only service around 40% of their clients regularly. If we take this to mean, on average, 80% of these people receive advice each year, then the total number of people receiving advice each year is $(2,000,000 \times 40\% \times 80\% =)$ 640,000. This is broadly consistent with the assumptions in this report.

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⁴ 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.

⁵ Source: ASIC Annual Report 2008-2009.

⁶ Note that the AFA has stated a figure of 3,000,000 people. We believe this figure is overstated and it has been discounted.

⁷ Money Management 14th January 2010.

5. Advice Market Model Before Regulatory Change

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

5.1 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 model⁸.

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; and
- 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; and
- 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; and
- Direct.

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⁸ Population Projections, Australia, 2006-2101, ABS catalogue number 3222.0, Medium Series.

5.2 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 4.1.5 above 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).

5.3 Business Projections

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

- Population movements, as described in Section 5.1 above;
- Superannuation contribution and withdrawal rates;
- Investment inflows to and outflows from managed investments;
- Investment returns;
- Fee and insurance premium deductions; and
- Tax.

These assumptions are consistent with those in the Rice Warner 2009 Superannuation Projections Report and 2009 Risk Insurance Projections Report.

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

5.4 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 5.1 above).

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

5.5 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 4.1.4 above and Appendix A to new and in force business as appropriate.

6. Advice Market Model after Regulatory Change

6.1 Population Model

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

6.2 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 projections⁹.

From these figure we have eliminated:

- Those who are unemployed (including children); and
- Those earning less than \$31,000 per annum.

This approach is not to suggest that those earning less than \$31,000 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 simple) depending on:

- Their earnings; and
- The calendar year concerned, with simple advice models becoming more prevalent as the years go by.

We have assumed the number of people receiving advice in the 12 months to 30th June 2010 is the same as in the “before regulatory change” scenario (see Sections 5.2 and 4.1.5 above).

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

Table 4. Proportion of people given advice in the 12 months to 30th June 2010

Earnings	Comprehensive	Less Complex	Simple
< \$41,500	0%	0%	0%
\$41, 500 to \$52,000	4%	6%	2%
\$52,001 to \$67,500	6%	9%	2%
> \$67,500	8%	12%	2%

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.

The assumption for simple advice reflects feedback from superannuation funds and their advice service providers. The take-up of simple advice is currently low.

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⁹ Population Projections, Australia, 2006-2101, ABS catalogue number 3222.0, Medium Series.

The assumptions in Table 4 above mean that the total number of pieces of advice provided in 2010 is 654,000, as stated in Section 4.1.5 above.

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

Table 5. Future Take-up of Advice in 12 Months to 30th June 2011

Earnings	Proportion of people given advice in					
	2011			2023		
	Comprehensive	Less Complex	Simple	Comprehensive	Less Complex	Simple
< \$31,100	0%	0%	0%	0%	0%	0%
\$31,101 to \$41,501	0%	0%	2%	0%	0%	15%
\$41,500 to \$52,000	4%	6%	4%	4%	6%	15%
\$52,001 to \$67,500	6%	9%	4%	6%	9%	15%
> \$67,500	8%	12%	4%	8%	12%	15%

Average fees have been assumed to be \$5,000 for comprehensive advice and \$1,500 for less complex advice. In addition:

- 30% of those obtaining comprehensive or less complex investment advice are assumed to obtain advice on risk insurance, for an additional fee of \$2,500; and
- 30% of those obtaining simple investment advice are assumed to obtain simple advice on risk insurance, for an additional fee of \$250.

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 \$67,500 per annum will have relatively simple financial circumstances, leading them to obtain only simple advice or none at all.

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

6.2.1 Demand for Advice

The demand for 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.

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 above, it is assumed that in the 12 months to 30th June 2011 (the first year after the regulatory change) 3% of those earning more than \$41,500 per annum (and 1% of those earning between \$31,100 and \$41,500 per annum) will obtain simple advice. This represents a 50% increase on the level assumed in the 12 months to 30th June 2010. The key driver of this increase is the assumed increase in the supply of advice, as discussed in Section 6.2.2 below.

6.2.2 Supply of Advice

Many superannuation funds have established simple 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 200 people giving simple advice across the market.

Note that, in practice, many advisers employed by superannuation funds provide all levels of advice. Therefore the figure of 200 simple advisers represents “the equivalent of 200 full time simple advisers”. These advisers are employed by IFFP, Money Solutions, QInvest, Mercer, other advice companies servicing superannuation funds and a number of funds that employ advisers directly, such as GESB and Sunsuper.

Simple advice services are not currently marketed actively and funds usually respond to in-bound requests for advice rather than pro-actively offering advice to members via marketing and out-bound campaigns. Some funds provide simple 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 simple advice is driven more by the supply (or lack of supply) of advice services rather than the demand for them.

We are aware of a number of funds that are reviewing their member advice strategies and some that are developing larger scale advice platforms and out-bound communication strategies, 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.

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 simple 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 will need to employ between 200 and 250 additional advisers each year¹⁰. 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.

6.2.3 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, a large industry superannuation fund agreed to make available optimal pricing analysis it has undertaken on a range of financial advice products.

The study involved 1,700 respondents in total and sought information on the likely demand for financial advice products across four market segments:

- Young;
- Settled;
- Pre-retirees; and
- Retirees.

Demand for full service, intermediate and simple advice products was tested at a range of price points.

Across the market segments and products price elasticity¹¹ varied from 0.5 to 1.7 with a midpoint price elasticity around 0.9.

As expected, all of the advice products 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 of \$3,369 in 2010 (\$3,650 for complex advice and \$325 for simple advice taking into account the provision of risk insurance advice to 30% of advice seekers). After the regulatory change the weighted average cost of advice falls to \$1,739 by 2023 (driven mainly by the increase in demand for simple advice relative to complex advice)¹².

Compared to the pre regulatory change scenario demand increases from 740,000 pieces of advice to 1,640,000 pieces of advice. These outcomes are consistent with an elasticity of around 1.16 (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.

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¹⁰ Except in the 12 months to 30th June 2011 when 281 additional advisers are assumed to be employed.

¹¹ Increase in demand as a proportion of the reduction in price or reduction in demand as a proportion of the increase in price.

¹² All fees are expressed in 2009 dollars

The use of elasticities can only provide a guide to likely demand. It is worth noting that simple, single issue advice is unlikely to be a good substitute for full service financial advice. However, tailored intra-fund advice at an intermediate price point may prove to be a very attractive substitute.

Among pre-retirees, there was demand for a tailored financial advice product encompassing pre-retirement planning and transition to retirement strategies at a price point of \$800 from 31% of respondents in the optimal pricing study.

There was demand for low cost single issue advice from 23% of young respondents and from almost one third of settled and pre-retirees.

These estimates of absolute demand compare favourably to the projections in this report which assume demand for simple advice peaks at 15%, less complex advice at 12% and complex advice at 8% for segments of the working population.

On this basis the supply side assumptions used in this report to determine likely demand are likely to be conservative.

6.3 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; and
- 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.

6.4 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 5.2 above). 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 comprehensive 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 6.2 above.

On the other hand, the need for simple or single issue financial advice, such as the level of contributions required to meet a superannuation fund members desired pension payments in retirement, 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 salaried advisers employed by superannuation funds (across all the superannuation market segments). However, simple advice models are still in their infancy across the industry and marketing of such services is patchy at best. We would anticipate simple advice being provided for a cost of around \$250, compared with an average price of \$2,900 for full financial advice¹³. Therefore, initially the infrastructure will not exist to ensure that all those who need simple advice will receive it.

Ultimately, we anticipate that, after the regulatory change, 1,000,000 pieces of financial advice will be provided in 2015 compared with 700,000 if the change did not take place, driven by:

- The further development of advice models by superannuation funds and therefore better access by members to simple advice;
- Increased sales to bank customers based on sophisticated data-mining and customer segmentation; and
- Data mining of superannuation member bases to improve knowledge of needs and target advice accordingly.

6.5 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 4.1.4 above and Appendix A to new and in force business and as advice is assumed to be given.

As discussed in Section 5.2 above, different groups of people have been assumed to obtain different levels of advice.

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¹³ In fact we have assumed that 40% of those obtaining “full financial advice” will obtain complex advice for a fee of \$5,000 and the other 60% will obtain simpler advice, such as setting up a transition to retirement strategy, for a fee of \$1,500. In addition, we have assumed that 30% of both these groups will obtain advice on risk insurance for a fee of \$2,500.

7. Projection Results

Table 6 below 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 th June	Commission and Fees			Total \$M	Number of Advisers	Average payment per Adviser \$'000
	Superannuation Business \$M	Managed Investments \$M	Risk Insurance \$M			
2010	1,063	547	1,104	2,714	16,293	174
2011	1,155	603	1,210	2,967	16,291	185
2012	1,251	664	1,323	3,238	16,544	199
2013	1,352	732	1,444	3,528	16,772	213
2014	1,458	807	1,574	3,839	16,979	229
2015	1,569	889	1,715	4,172	17,170	246
2016	1,684	979	1,866	4,529	17,342	264
2017	1,804	1,078	2,029	4,911	17,494	283
2018	1,928	1,186	2,204	5,318	17,629	304
2019	2,056	1,305	2,379	5,739	17,702	326
2020	2,187	1,436	2,565	6,188	17,760	350
2021	2,324	1,579	2,762	6,666	17,799	375
2022	2,467	1,737	2,971	7,174	17,825	403
2023	2,614	1,910	3,189	7,713	17,831	433
2024	2,766	2,101	3,421	8,288	17,828	465

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

Table 7 below shows the same information expressed in 2009 dollars.

Table 7. Adviser Market Before Regulatory Change - in 2009 Dollars

12 Months to 30 th June	Commission and Fees			Total \$M	Number of Advisers	Average payment per Adviser \$'000
	Superannuation Business \$M	Managed Investments \$M	Risk Insurance \$M			
2010	1,032	531	1,072	2,635	16,293	169
2011	1,088	568	1,140	2,797	16,291	175
2012	1,145	608	1,211	2,964	16,544	182
2013	1,202	651	1,283	3,135	16,772	189
2014	1,258	696	1,358	3,312	16,979	197
2015	1,314	744	1,436	3,494	17,170	206
2016	1,369	796	1,517	3,683	17,342	214
2017	1,424	851	1,602	3,876	17,494	224
2018	1,478	909	1,689	4,076	17,629	233
2019	1,530	971	1,770	4,271	17,702	242
2020	1,580	1,037	1,853	4,471	17,760	253
2021	1,630	1,108	1,937	4,675	17,799	263
2022	1,680	1,183	2,023	4,885	17,825	274
2023	1,728	1,263	2,108	5,099	17,831	286
2024	1,776	1,348	2,196	5,320	17,828	298

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

Table 8 below shows the total commission and fees and advisers as Table 6 above 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 th June	Business Volume				Number of Advisers
	Superannuation Business FUA in \$M	Managed Investments FUA in \$M	Total Investment Business FUA in \$M	Risk Insurance APIUA in \$M	
2010	233,634	116,366	350,000	5,548	16,293
2011	259,126	128,292	387,419	6,080	16,291
2012	285,992	141,415	427,407	6,651	16,544
2013	314,298	155,839	470,137	7,258	16,772
2014	343,890	171,680	515,570	7,913	16,979
2015	374,838	189,074	563,912	8,621	17,170
2016	407,121	208,169	615,289	9,385	17,342
2017	440,707	229,131	669,838	10,204	17,494
2018	475,428	252,143	727,572	11,088	17,629
2019	511,175	277,416	788,591	11,967	17,702
2020	548,368	305,169	853,537	12,906	17,760
2021	586,984	335,652	922,636	13,897	17,799
2022	627,314	369,143	996,457	14,946	17,825
2023	668,466	405,978	1,074,444	16,045	17,831
2024	711,425	446,529	1,157,954	17,213	17,828

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 twelve months to 30th June 2010 (\$2.6bn) are anticipated to represent 0.24% of GDP.

Tables 9, 10 and 11 below set out corresponding information to Tables 6, 7 and 8 above but assume that the change in regulations set out in Section 1 occur on 1st July 2010. It is assumed that up front commissions are banned on additions to existing client accounts (superannuation, managed investments and risk insurance) as well as on new accounts.

Table 9. Adviser Market After Regulatory Change - in Future Dollars

12 Months to 30 th June	Commission and Fees			Number of Advisers	Average payment per Adviser p.a. \$'000
	Commission \$M	Fees \$M	Total \$M		
2010	2,696	18	2,714	16,293	174
2011	1,484	2,327	3,811	21,237	234
2012	1,326	2,448	3,774	19,722	178
2013	1,138	2,572	3,710	18,213	188
2014	920	2,701	3,621	16,742	199
2015	673	2,836	3,509	15,224	210
2016	397	2,967	3,363	13,874	221
2017	137	3,113	3,250	12,750	234
2018	113	3,266	3,379	12,549	265
2019	92	3,424	3,517	12,381	280
2020	76	3,589	3,665	12,247	296
2021	62	3,762	3,824	12,142	312
2022	51	3,940	3,991	12,057	329
2023	41	4,126	4,167	11,991	346
2024	34	4,317	4,351	11,942	363

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

Table 10. Adviser Market After Regulatory Change - in 2009 Dollars

12 Months to 30 th June	Commission and Fees			Number of Advisers	Average payment per Adviser p.a. \$'000
	Commission \$M	Fees \$M	Total \$M		
2010	2,617	17	2,635	16,293	169
2011	1,399	2,194	3,592	21,237	220
2012	1,214	2,240	3,454	19,722	163
2013	1,011	2,285	3,296	18,213	167
2014	793	2,330	3,123	16,742	171
2015	564	2,375	2,939	15,224	176
2016	323	2,412	2,735	13,874	180
2017	108	2,458	2,566	12,750	185
2018	86	2,503	2,589	12,549	203
2019	69	2,548	2,617	12,381	209
2020	55	2,593	2,648	12,247	214
2021	43	2,638	2,682	12,142	219
2022	34	2,683	2,718	12,057	224
2023	27	2,727	2,755	11,991	228
2024	22	2,771	2,793	11,942	233

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 th June	Business Volume				Number of Advisers
	Superannuation Business FUA in \$M	Managed Investments FUA in \$M	Total Investment Business FUA in \$M	Risk Insurance APIUA in \$M	
2010	233,630	116,366	349,996	5,548	16,293
2011	259,411	140,242	399,653	6,080	21,237
2012	286,872	163,932	450,804	6,651	19,722
2013	316,131	186,532	502,663	7,258	18,213
2014	347,114	207,250	554,365	7,913	16,742
2015	379,967	224,865	604,831	8,621	15,224
2016	413,890	235,658	649,548	9,385	13,874
2017	450,564	244,228	694,792	10,204	12,750
2018	488,843	271,870	760,713	11,088	12,549
2019	528,639	302,623	831,261	11,967	12,381
2020	570,436	336,845	907,281	12,906	12,247
2021	614,256	374,947	989,203	13,897	12,142
2022	660,417	417,339	1,077,757	14,946	12,057
2023	708,021	464,554	1,172,574	16,045	11,991
2024	758,145	517,180	1,275,325	17,213	11,942

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

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

- Total adviser remuneration will be broadly unchanged in the third year after the introduction of the new regulations (i.e. the year to 30th June 2013) and reduce by \$1.8bn in the 10th year after the change (in 2009 Dollars). This includes fee income to superannuation funds for the provision of advice to members by salaried advisers;
- The overall number of advisers operating in the market will be slightly higher until 2014 but will then decline so that, by 2024 there will be 33% less advisers (in total) if the regulatory change occurs than if it does not; and
- Total commission and fees paid increase slightly from 0.25% of GDP (or \$2.7bn) in 2009/10 to 0.26% of GDP (or \$4.4bn) in 2023/2024. If the regulatory change does not occur, total commission and fees paid will increase to 0.50% of GDP (\$8.3bn) in 2024. 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.

However, in the short term the change to fees for service also has a dampening impact. This is because up front commissions on 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 changes 1% up front commission on each contribution, then the first year commission is \$1,000. Under an advice fee regime, the adviser may charge \$3,000 up front. Obviously, trail commissions would ensure that overall commission payments over the years are greater. However, in the short term, adviser remuneration in this example has increased.

As discussed in Section 2.3 above, there are examples of fee paid advice models currently operating in the market that provide the equivalent advice for lower overall fees.

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 advisers. More simple advice (including single issue and intra-fund advice) will be provided, particularly by salaried advisers in superannuation funds. The skills required for this work will be different, for example:

- The advice process will be more automated, given its more simple 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; and
- Remuneration structures are clearly very different with rewards for simple advisers (as defined in Section 1.2 above) 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 below show an estimated breakdown of advisers between full service financial advisers and simple advisers, before and after the regulatory change respectively. This breakdown is indicative only. In reality there are advisers who provide both full service and simple advice.

Table 12. Number of Advisers Before Regulatory Change

30th June	Number of Advisers Giving Full Advice	Number of Advisers Giving only Simple Advice	Total Advisers	Number of piece of Full Advice	Number of piece of Simple Advice	Total piece of Advice
2009	15,355	200	15,555	598,761	55,385	654,146
2010	15,812	203	16,015	609,080	56,215	665,296
2011	16,085	206	16,291	618,539	57,046	675,586
2012	16,335	209	16,544	627,064	57,877	684,941
2013	16,560	212	16,772	634,803	58,708	693,511
2014	16,764	215	16,979	641,944	59,538	701,482
2015	16,952	218	17,170	648,375	60,369	708,744
2016	17,121	221	17,342	654,058	61,200	715,258
2017	17,270	224	17,494	659,105	62,031	721,136
2018	17,402	227	17,629	661,834	62,862	724,696
2019	17,472	230	17,702	664,003	63,692	727,695
2020	17,527	233	17,760	665,461	64,523	729,984
2021	17,563	236	17,799	666,433	65,354	731,787
2022	17,586	239	17,825	666,657	66,185	732,842
2023	17,589	242	17,831	666,545	67,015	733,560

Note: When people seek advice on super and/or investment and/or risk it is counted only once in the number of pieces of advice.

Table 13. Number of Advisers After Regulatory Change

30th June	Number of Advisers Giving Full Advice	Number of Advisers Giving only Simple Advice	Total	Number of piece of Full Advice	Number of piece of Simple Advice	Total piece of Advice
2009	15,355	200	15,555	598,761	55,385	654,146
2010	15,812	481	16,293	607,174	133,247	740,421
2011	20,549	688	21,237	615,221	190,642	805,863
2012	18,822	900	19,722	622,565	249,315	871,880
2013	17,096	1,117	18,213	629,919	309,384	939,303
2014	15,403	1,339	16,742	637,249	370,803	1,008,051
2015	13,763	1,461	15,224	644,662	404,573	1,049,235
2016	12,183	1,691	13,874	651,873	468,194	1,120,067
2017	10,826	1,924	12,750	658,886	532,920	1,191,806
2018	10,387	2,162	12,549	665,676	598,642	1,264,318
2019	9,978	2,403	12,381	672,422	665,504	1,337,927
2020	9,598	2,649	12,247	679,228	733,565	1,412,793
2021	9,244	2,898	12,142	685,708	802,501	1,488,209
2022	8,907	3,150	12,057	691,990	872,319	1,564,309
2023	8,586	3,405	11,991	698,057	942,967	1,641,024

Note: When people seek advice on super and/or investment and/or risk it is counted only once in the number of pieces of advice.

8. Cost of Buying Out Financial Advice Practices

One consequence of the reduction in the overall number of full financial advisers operating in the industry is that financial institutions, either dealer groups or product providers, might “buy out” the remaining flow of future trail commission payments due to advisers when they leave the industry.

Buy-outs are already common in the market but in many cases the business is “on-sold” to other advisers. Therefore the capital cost to buyers each year is a net cost (acquisitions less disposals).

We have estimated the cost to the industry of the additional buy-outs that might occur due to the reduction in adviser numbers. We have done this on a net basis, in other words the costs of buy-outs less the income from disposals.

Table 14 below shows the year-by-year net cost of buy-outs.

Table 14. Cost of buying out

12 Months to 30th June	Cost of buying Business \$M
2010	-
2011	-
2012	446
2013	418
2014	364
2015	287
2016	182
2017	61
2018	18
2019	15
2020	12
2021	9
2022	7
2023	6
2024	5

It should be noted that the values of dealer groups are heavily dependant on the future flow of trail commission and platform and fund manager rebates. The grandfathering rules assumed in this report effectively protect much of that value for the owners. Without such a provision the values of many dealer groups would reduce substantially and they would not be able to realise the buy-out values indicated in Table 14 above.

9. Sensitivities

We have tested the impact of changes to our assumptions on the outcome across the financial advice market. Table 15 below shows the impact of changes in various assumptions on:

- Total commission and fees;
- Total piece of advice; and
- Numbers of financial advisers.

Table 15. Sensitivities

Scenario	After 2 Years (2012)			After 5 Years (2015)			After 10 Years (2020)		
	Total Commission and Fees	Total piece of Advice	Number of Advisers	Total Commission and Fees	Total piece of Advice	Number of Advisers	Total Commission and Fees	Total piece of Advice	Number of Advisers
Before Regulatory Change	3,238	675,586	16,544	4,172	701,482	17,170	6,188	727,695	17,760
After Regulatory Change:									
Base assumptions (see Section 4 above)	3,774	805,863	19,722	3,509	1,008,051	15,224	3,665	1,337,927	12,247
Up front commission continues to be permitted on existing accounts	4,148	805,863	21,621	3,710	1,008,051	16,045	3,665	1,337,927	12,247
Advise fees 20% lower, usage of both full and simple financial advice 20% higher	3,603	967,036	18,828	3,200	1,209,662	13,927	3,521	1,605,512	11,766
Advise fees 20% higher, usage of both full and simple financial advice 20% lower	3,760	644,691	19,625	3,643	806,441	15,738	3,521	1,070,341	11,766
20% less usage of simple financial advice in all years	3,731	767,735	19,387	3,452	933,891	14,812	3,607	1,204,826	11,716
20% less usage of full financial advice in all years	3,421	682,819	17,929	3,273	880,602	14,260	3,005	1,203,442	10,370
20% less usage of both full and simple financial advice in all years	3,368	644,691	17,547	3,190	806,441	13,740	2,947	1,070,341	9,840
20% more usage of simple financial advice in all years	3,817	843,992	20,051	3,566	1,082,212	15,632	3,723	1,471,028	12,776
20% more usage of full financial advice in all years	4,154	928,907	21,647	3,839	1,135,501	16,572	4,324	1,472,411	14,124
20% more usage of both full and simple financial advice in all years	4,190	967,036	21,946	3,881	1,209,662	16,921	4,383	1,605,512	14,654
Change does not apply to risk insurance	4,250	805,863	22,137	4,464	1,008,051	19,125	5,470	1,337,927	17,385

Note: When people seek advice on super and/or investment and/or risk it is counted only once in the number of piece of advice.

Particular note should be taken of the impact of the alternative “grandfathering” rule under which advisers would still be able to charge up front commission on additional contributions to existing superannuation accounts (the “Up front commission continues to be permitted on existing accounts” scenario in Table 15 above). The impact of this change would be to increase overall payments to advisers by 9.7% in 2012, although they would become lower subsequently.

In the event that legislation or regulations are introduced which ban payments from product providers to advisers but with “grandfathering” of existing member accounts, it would be important to specify the treatment of **additional contributions to existing accounts** and whether or not they fall under the old or new regime. This could have a significant impact on the overall amount of commission and fees paid.

What has not been projected is the effect of dealer groups buying out financial planning practices and being required to seek approval from clients to continue charging commissions.

Appendix A Commission Rates

Table 16 below sets out assumed average rates of commission (including rebates and volume overrides) and fees.

Table 16. Commission and Fee assumptions

Commission type	Business type	Amount ¹⁴
Up front commission rate	Investment (as % of FUA)	1.0%
	Risk Insurance (as % of new premiums)	110%*
Trail commission rate	Investment (as % of FUA)	0.35%
	Risk Insurance (as % of premiums in force)	10%
Up front Fee paid (\$)	Comprehensive advice (per advice)	<ul style="list-style-type: none"> • \$5,000 for complex advice (40% of cases); • \$1,500 for less complex cases; • Average \$2,900
	Simple advice (per advice)	\$250
	Risk Insurance (per advice)	\$2,500

* 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.

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¹⁴ All dollar amounts are in 2009 dollars