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RICEwarner ACTUARIES

The financial advice industry post FoFA

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1. Executive summary

1.1 Our brief

Rice Warner has been engaged by Robbie Campo of Industry Super Network (ISN) to estimate the impact of the 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. Our report *The Financial Advice Industry Post FoFA, January 2012* (the January 2012 report) presented an update of the March 2010 report reflecting some significant differences in the proposed FoFA changes.

This report reflects the final FoFA legislation and regulations available at June 2013 and up-to-date market information as at 30 June 2012.

For the purposes of clarity, we have included much of the background information that was contained in the March 2010 and January 2012 reports. Consequently, the current report can be read in isolation. However, references are made to the earlier reports 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 legislation and regulations 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 regulatory changes on the development of the financial advice industry.

1.2 Key conclusions

1.2.1 Shift in advice

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

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

The 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
- 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 2026/2027 it is estimated that 1.88 million pieces of advice will be provided – more than double the 893,000 pieces of advice under a no reform scenario. This is mainly driven by the increase of scaled advice from 198,000 pieces in 2026/2027 under a no reform scenario to more than 1.1 million with the reform.

In addition, the increased provision of more affordable scaled advice will result in a significant reduction in the average cost of advice from an average of $2,046 before the reforms to $1,163 after the reforms by 2026/2027, in 2012 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 8.7% per annum. The continued aging of the population and the maturation of the superannuation system, including the phased increase of the Superannuation Guarantee (SG) 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 occurring.
- Simplification of the regulatory framework surrounding the provision of advice. For example, scaled advice rules have recently been clarified and simplified. This has allowed advice to be delivered more quickly and with less paperwork.

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
- enhance administration systems to provide easy access to member data to support the advice process.

1.2.4 Consumer reaction to regulatory change

With explicit fees, many people will re-assess the cost of financial advice. 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-b-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 scaled 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 11 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 (Demand elasticity for financial advice).

The growth in single issue advice will come from two main sources, namely industry fund members and bank/wealth manager 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

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

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

While it is difficult to make precise estimates of employment impacts (especially over the long term) this report finds that the FoFA reforms are likely to provide a short term boost to total adviser employment before settling toward a total level of employment broadly similar to the levels that exist today. For example, after 10 years, total adviser employment is estimated to be 17,375 at 30 June 2023 compared to 18,096 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 2027, total employment of advisers will be broadly similar to the levels existing today. 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 (18,667 by 30 June 2023) compared to today (18,096 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 17,750, is likely to increase slightly in five years' time and then decline to around 15,000 in 2027. However, this will be offset by an additional 2,700 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.

In this context, it is important to emphasise that whilst we have developed a simplified model involving two distinct types of adviser, those providing full advice and those providing scaled advice, in reality individual advisers may provide both types of advice. As such, the numerical split between the two types of advisers in this report is to some extent artificial.

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 pre-FoFA regulatory regime projected out for the next 15 years. It compares this with the corresponding amounts estimated to be paid after the regulatory changes have been implemented.

Table 1. Estimated commission and fees – in future dollars

12 months - 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)	
2013	3,482	3,482	0	0	192	192
2014	3,819	4,947	-1,129	-30	207	265
2015	4,170	5,029	-859	-21	223	265
2016	4,572	5,069	-497	-11	242	266
2017	5,031	5,066	-35	-1	262	267
2018	5,292	5,001	291	5	274	271
2019	5,803	5,000	803	14	298	281
2020	6,352	5,116	1,236	19	322	295
2021	6,920	5,474	1,447	21	348	318
2022	7,524	5,841	1,682	22	377	339
2023	7,876	6,236	1,640	21	393	360
2024	8,523	6,648	1,875	22	425	382
2025	9,218	7,084	2,134	23	460	405
2026	9,955	7,541	2,414	24	497	430
2027	10,735	8,014	2,721	25	535	455

Note: Average adviser payments stated in the table above are combined averages across both full and scaled advice and advisers.

After the regulatory change:

- There will be a bring-forward of fee revenue associated with a movement towards fee for service. Hence, there will be an increase in total and average payments to advisers in the 12 months to 30 June 2014.
- There will a net increase in the amount of advice provided. By 2018, 425,000 additional pieces of advice will be provided and by 2027, 1,082,000 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 advice 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 will be removed under the FoFA 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 \$2.7 billion (in future dollars) in 2027 (or \$1.7 billion in 2012 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 \$144 billion (in future dollars) by 2027[4].

Table 2 shows the same information as Table 1, but expressed in 2012 dollars

Table 2. Estimated commission and fees – in 2012 dollars

12 months - 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)	
2013	3,380	3,380	0	0	187	187
2014	3,599	4,663	-1,064	-30	195	247
2015	3,816	4,602	-786	-21	204	241
2016	4,062	4,503	-441	-11	215	236
2017	4,340	4,370	-30	-1	226	233
2018	4,432	4,188	244	5	229	231
2019	4,718	4,065	653	14	242	232
2020	5,014	4,039	976	19	255	235
2021	5,304	4,195	1,109	21	267	244
2022	5,598	4,347	1,252	22	280	251
2023	5,690	4,505	1,185	21	284	259
2024	5,978	4,663	1,315	22	298	267
2025	6,277	4,824	1,453	23	313	276
2026	6,582	4,985	1,596	24	328	284
2027	6,890	5,144	1,747	25	344	276

[3] Assuming growth in real GDP as in the 2010 Intergenerational Report
[4] Note that this figure includes the impact of additional private savings being brought under advice as described in Section 9.3 (Business projections).

1.2.6 Cost benefit analysis

A detailed cost benefit analysis of the FoFA reforms falls outside the scope of this report. However, given the impacts on adviser remuneration (client fees) and industry estimates of the costs, it is possible to provide a high-level analysis.

A cost benefit analysis allows the benefits and costs over the short, medium and longer term to be compared on an equivalent basis to assess the value of the reforms.

Appendix B (Cost benefit analysis) sets out the methodology that has been adopted and the rationale for the assumptions made. In essence, it has been assumed that:

- The gross **benefits** from the reforms consists of the projected reduction in adviser remuneration (client fees), adjusted to reflect the pass through half the costs of FoFA (both implementation and ongoing) to customers. See Appendix B, Table 16 for details.
- The **costs** of FoFA implementation including; systems changes to grandfather commissions, implement fee for service charging, client fee disclosures and training, including compliance with regulations covering the provision of scaled advice and the best interests duty; are assumed to be in the range of $350 million to $700 million with ongoing costs between $187.5 million to $375 million in current dollar terms.

The compliance cost estimate range reflects 'whole of industry' estimates by the Financial Services Council following a survey of its members[5] and early evidence of operational provisions disclosed by AMP, BT, and MLC to shareholders and the media[6]. These reported costs have not been independently verified by Rice Warner but, given that they have been the subject of shareholder and public disclosure, they represent a reasonable basis for what an informed assumption of total compliance cost range may be. Rice Warner has previously provided initial estimates of the marginal cost on the opt-in provisions. However, this constitutes only a small part of the overall cost of the FoFA reforms.

It is important to note that consumers' net benefits are apparent early in the reforms; however, the purpose of this cost benefit assessment is to compare consumer benefits to the costs also borne by the industry and its shareholders.

On this basis, assuming costs and benefits are discounted at a rate of 7% per annum, the overall benefits to costs ratio (BCR) is estimated to be in the range of 1.7 to 2.9 over 15 years, depending on the actual compliance costs incurred. In the short term the benefits are lower, reflecting the delay before the full impact of the FoFA changes occur and the impact of grandfathering. For this reason it is appropriate to consider the BCR over the 15 year timeframe of this report and the savings objectives of the retirement income system.

It should be noted that this estimated BCR takes no account of the following which would tend to increase it further:

- The increased provision of advice which would directly improve savings such as the implementation of optimal contribution strategies to superannuation.

[5] Mr John Brogden, Parliamentary Joint Committee on Corporations and Financial Services, Hansard, 23 Jan 2012
[6] AMP Press Release, 16 August 2012, disclosed one off costs for FoFA, Stronger Super, and other regulatory changes between $60 million to $75 million. MLC's submission to the Parliamentary Joint Committee on Corporations and Financial Services estimated ongoing fee disclosure will have a one off cost of $3 million to $6 million and an ongoing cost of $0.5 million per annum. BT has disclosed its FoFA preparations have cost "tens of millions of dollars" (http://www.moneymanagement.com.au/news/warren-dunne-bt-fofa-compliance-costs-in-millions). Both BT and AMP's disclosures appear to be of the same quantum with each holding around 20 percent market share. If their costs were replicated across the industry it would imply up front compliance costs of $300 million to $350 million which is half of the FSC estimate.

- Stated implementation costs which also capture product and business process rationalisation which would otherwise have been incurred as a separate project. We are aware of a number of instances where, for convenience, business rationalisation initiatives have been captured under the organisation's regulatory reforms change project.
- The impact of any additional net investment returns driven by merit based product selection.
- The long-term impact of higher superannuation fund balances on the cost, to government, of the Age Pension.

Appendix B also provides an analysis of the sensitivity of the results to changes in assumptions. The BCR is most sensitive to the estimate of implementation and compliance costs. For example, if the actual implementation and compliance costs are in line with shareholder and public disclosures by major institutions rather than industry association estimates the benefits outweigh the costs almost three times over 15 years rather than one-and-a-half times.

1.2.7 Comparison with the January 2012 report

The key differences in the results presented in this report compared with those in the January 2012 report are:

- The number of financial advisers at 30 June 2012 is estimated to be 18,096, compared with 17,711 estimated in the January 2012 report. This reflects stronger growth in adviser numbers over the past two years than had been anticipated.
- The January 2012 report estimated that the number of advisers would increase immediately after the regulatory change and then gradually decrease. In this report we have assumed that the initial transition to the new regulatory environment will not lead to such a significant short term boost in adviser numbers. As such, the progression of adviser numbers is smoother than in the previous report.
- The January 2012 report estimated that the number of advisers in the market would reduce by approximately 5% over the 14 years following the regulatory change. The current report estimates that the number will decrease by approximately 4%, broadly similar to the result of the January 2012 report, with the final outcome being subject to commercial strategies adopted my market participants in response to the reforms.

This report was prepared and peer reviewed for Industry Super Network by the following consultants.

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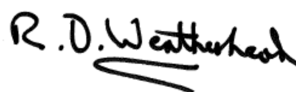

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2. The FoFA and related regulatory changes

At the time of writing, whilst the FoFA legislation has been enacted, some of the associated regulations are yet to be finalised.

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[7] entered into before 1 July 2013[8].
- 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.
- An exemption from the opt-in provisions where an ASIC approved code of conduct exists[9].
- A ban on asset based fees in relation to borrowed amounts.

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 July 2014. All existing default superannuation account balances will have to be transferred to MySuper by 1 July 2017, although funds are being encouraged to complete this exercise before then. 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.

[7] Although platform rebates would not be grandfathered, except via regulatory exemption.
[8] New investments under existing client arrangement up to 30 June 2014 will also be grandfathered.
[9] Refer to *ASIC regulatory guide RG 183 (Approval of financial services sector codes of conduct).*

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 2013 will have moved into post-FoFA 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[10] 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-2013 arrangements* means advice provided and resulting products acquired under financial advice remuneration structures arranged up to 1 July 2013.
- *Post-2013 arrangements* means any advice provided or resulting financial products acquired which are not classified as pre-2013 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:
  - **Upfront 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.

[10] Including intra-fund advice, although this term will cease in a legal sense on 1 July 2013.

- *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 January 2012 report

4.1 Starting position

The January 2012 report had a start date of 30 June 2011. The current report has been updated to reflect the starting position of 30 June 2012. 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 Changes in investment market projections

In this report the size of the personal investments market under advice is estimated according to projections set out in the *Rice Warner Personal Investment Market Projections Report 2012*. This assumes a smaller overall personal investments market, but we have now assumed that a higher proportion of the market is under advice. As a result, the market under advice is broadly similar to that in the January 2012 report *Financial Advice Industry Post FoFA*.

4.3 Changes in superannuation market projections

The *Rice Warner Superannuation Market Projections Report 2012* showed significant growth in the personal superannuation market over the next 15 years. However, much of this growth relates to low cost personal superannuation products that are unlikely to be under advice. Hence, we have adjusted the personal superannuation business volumes that report to allow for the proportion that is under advice and adopted those adjusted business volumes in this report.

5. The advice market before FoFA

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.

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[11] 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 superannuation to achieve their desired retirement lifestyle
- much insurance cover is required to provide for family members and dependants
- to benefit from government incentives such as co-contributions.

[11] *Money Management, 14 January 2010.*

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 issue 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.

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.

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
- shop around to obtain a lower price for the advice service
- 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
- 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 FoFA 'grandfathering' arrangements[12], 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.

[12] We note that these are yet to be finalised at the time of writing.

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 arrangement

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 Future scaled advice clients

We expect the amount of scaled advice provided across the market 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
- enhance administration systems to provide easy access to member data to support the advice process.

The take up of scaled advice is expected to be higher after the FoFA reforms than would otherwise have been the case. This will be driven by a combination of:

- advisers establishing scaled advice business models to help fill the revenue gap created by the shift to fee for service advice
- greater consumer awareness of the cost of full advice, leading to a shift to piece-by-piece or scaled advice
- consumers who are not currently serviced actively by their adviser making a conscious decision not to opt-in for ongoing advice and then being more likely to seek scaled advice.

As such, the projections in this report show significantly higher numbers of advisers providing scaled advice after the FoFA reforms than would have been the case without the reforms. It is important to note that this difference can be misinterpreted because of the artificial separation on advisers into two distinct categories, those providing full advice and those providing scaled advice. In reality, some advisers will provide both types of advice so, in this report, the number of advisers providing scaled advice is and 'equivalent number' that would exist if all scaled advice were provided by specialist scaled advisers.

6.4 Impacts 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 hold the superannuation of both partners. Consequently, the information required to provide a comprehensive plan is not immediately available.

Nonetheless, scaled 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, 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 comes into effect which, amongst other things, prevents the automatic transfer of a MySuper member's account without their consent.

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 2012 was around 17,750. 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 17,750 authorised representatives in the market. However, a higher proportion of them sell little or no business, so 17,750 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 350. 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 the Rice Warner Personal Investments Market Projections Report 2012. It has been assumed that 80% of this business is under advice by financial advisers. The 80% 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 June2012

Business	Volume at 30 June 2012 ($M)
Superannuation FUA	246,090
Managed Investments FUA	105,588
Total Investment Business	351,678
Risk Insurance APIUA	6,367

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 market segment. 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:

- Approximately 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[13].
- 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 through 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

We estimate that around 2,050,000 people have received advice from a financial adviser at some time during 2011-2012 financial year, based on statistics from ASIC [14]. 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 2,050,000 people receive financial advice on an annual basis and the remaining 85% receive advice every 3.2 years. This leads to an assumed number of pieces of advice being 797,002 per annum, across all forms of advice and all types of advice remuneration.

[13] 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.

[14] Estimated according to ASIC Annual Report 2009-2010, which suggest that around 1,800,000 people have received advice from a financial adviser at some time.

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 Projections Report. It allows for population growth through births and immigration, offset by deaths and emigration and is calibrated to the ABS population model[15].

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.

[15] *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 Market Projections Report 2012* and *Risk Insurance Market Projections Report 2012*.

The managed investments model assumes capital inflows are 25% greater than outflows. This assumption is consistent with the *Rice Warner Personal Investment Market Projections Report 2012*.

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[16].

From these figure we have eliminated those:

- who are unemployed (including children)
- 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 2011 Census statistics.

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 2013 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 2013

Earnings	Comprehensive	Less complex	Scaled
	(%)		
< $53,000	0.0	0.0	0.0
$53,000 to $66,000	1.0	4.0	1.5
$66,001 to $86,000	3.0	7.0	2.0
$86,000 to $106,000	4.0	8.5	2.5
$106,001 to $132,000	5.0	10.0	3.0
> $132,000	7.0	13.0	3.5

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

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 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 2012-2013 is 797,000, 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 2014, after the regulatory change, vary by income category. The assumptions for 2012 and 2027 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 2027 levels.

Table 5. Future take-up of advice in 12 months to 30 June 2013 and 30 June 2027

Earnings[17]	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	0.5	0.0	0.0	14.0
$53,001 to $66,000	1.0	4.0	1.5	1.0	4.0	15.0
$66,001 to $86,000	3.0	7.0	2.0	3.0	7.0	15.5
$86,000 to $106,000	4.0	8.5	2.5	4.0	8.5	16.0
$106,001 to $132,000	5.0	10.0	3.0	5.0	10.0	16.5
> $132,000	7.0	13.0	3.5	7.0	13.0	17.0

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
- earning more than $132,000 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.

[17] In 2012 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. The key drivers of the increase in take-up of scaled advice after the regulatory change are the discussed in Section 6.3 (Future scaled advice clients) above.

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 350 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'[18].

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. However, the Stronger Super changes will lead some funds to move to direct charging models, on a full cost recovery basis.

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.

[18] Although future increases in the volume of scaled advice have, for simplicity, been attributed to scales advisers.

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 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[19] of demand for financial advice across a range of price points. This varied from 0.5 to 1.7 with midpoint price elasticity approximately 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 approximately 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[20] result in a weighted average cost of advice for superannuation and managed investing of $2,135 in 2012/2013 ($2,550 for full advice and $275 for scaled). After the regulatory change the weighted average cost of advice falls to $1,163 by 2026/2027 (driven mainly by the increase in demand for scaled advice relative to full advice)[21].

Compared to the pre regulatory change scenario demand increases from 797,000 pieces of advice to 1,878,800 pieces of advice. These outcomes are consistent with an elasticity of around 1.37 (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.

[19] Increase in demand as a proportion of the reduction in price or reduction in demand as a proportion of the increase in price.

[20] These assumptions are the same as used in January 2012 report, since average costs of advice in the market has not changed significantly since then.

[21] All fees are expressed in 2012 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 approximately $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, 1,144,000 pieces of financial advice will be provided in 2017 compared with 844,000 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 2013 we have projected business volumes separately in respect of:

- pre-2013 arrangements, covered by grandfathering and therefore subject to existing adviser remuneration terms
- post-2013 arrangement where the client has opted in for ongoing advice and asset based fees are therefore paid
- post-2013 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).

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 – 30 June	Commission and fees			Average payment per adviser	Total
	Superannuation business	Managed investments	Risk insurance		
	($M)			($'000)	($M)
2013	1,256	829	1,397	192	**3,482**
2014	1,338	941	1,540	207	**3,819**
2015	1,436	1,069	1,666	223	**4,170**
2016	1,552	1,214	1,805	242	**4,572**
2017	1,686	1,380	1,966	262	**5,031**
2018	1,838	1,313	2,141	274	**5,292**
2019	2,004	1,469	2,330	298	**5,803**
2020	2,173	1,644	2,535	322	**6,352**
2021	2,339	1,838	2,743	348	**6,920**
2022	2,511	2,057	2,956	377	**7,524**
2023	2,686	1,994	3,195	393	**7,876**
2024	2,866	2,208	3,448	425	**8,523**
2025	3,050	2,446	3,722	460	**9,218**
2026	3,236	2,706	4,014	497	**9,955**
2027	3,424	2,993	4,319	535	**10,735**

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 2012 dollars.

Table 7. Adviser market before regulatory change – in 2012 dollars

12 months – 30 June	Commission and fees			Average payment per adviser	Total
	Superannuation business	Managed investments	Risk insurance		
	($M)			($'000)	($M)
2013	1,219	805	1,356	187	**3,380**
2014	1,261	887	1,451	195	**3,599**
2015	1,314	978	1,524	204	**3,816**
2016	1,379	1,079	1,604	215	**4,062**
2017	1,454	1,190	1,696	226	**4,340**
2018	1,539	1,100	1,793	229	**4,432**
2019	1,629	1,195	1,894	242	**4,718**
2020	1,715	1,298	2,001	255	**5,014**
2021	1,793	1,409	2,102	267	**5,304**
2022	1,868	1,530	2,200	280	**5,598**
2023	1,941	1,440	2,308	284	**5,690**
2024	2,010	1,549	2,419	298	**5,978**
2025	2,077	1,665	2,535	313	**6,277**
2026	2,139	1,789	2,654	328	**6,582**
2027	2,197	1,921	2,772	344	**6,890**

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

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Table 8 shows the total commission and fees and advisers as in 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 – 30 June	Business volume			
	Risk insurance	Superannuation business	Managed investments	Total investment business
	APIUA in $M	FUA in $M		
2013	6,987	265,284	105,588	370,872
2014	7,699	284,070	119,554	403,624
2015	8,327	305,935	135,366	441,301
2016	9,025	331,383	153,269	484,652
2017	9,826	360,672	173,540	534,212
2018	10,701	394,080	193,901	587,980
2019	11,650	430,039	216,650	646,689
2020	12,678	468,315	242,069	710,384
2021	13,715	508,171	270,469	778,641
2022	14,787	549,846	302,202	852,049
2023	15,984	592,945	334,536	927,481
2024	17,251	637,355	370,329	1,007,684
2025	18,624	683,275	409,952	1,093,227
2026	20,084	729,608	453,814	1,183,422
2027	21,611	777,005	502,369	1,279,374

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 2013 ($3.5 billion) are anticipated to represent 0.25% of GDP.

Table 9, Table 10 and Table 11 set out corresponding information to Table 6, Table 7 and Table 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 – 30 June	Average payment per adviser p.a.	Commission and fees		
		Pre-2012 arrangements	Post-2012 arrangements	Total
	($'000)	($M)		
2013	192	3,482	0	**3,482**
2014	265	2,322	2,625	**4,947**
2015	265	2,002	3,027	**5,029**
2016	266	1,653	3,416	**5,069**
2017	267	1,257	3,809	**5,066**
2018	271	797	4,203	**5,001**
2019	281	405	4,595	**5,000**
2020	295	135	4,982	**5,116**
2021	318	110	5,364	**5,474**
2022	339	90	5,752	**5,841**
2023	360	74	6,162	**6,236**
2024	382	60	6,587	**6,648**
2025	405	49	7,035	**7,084**

Table 10. Adviser market after regulatory change – in 2012 dollars

12 months – 30 June	Average payment per adviser p.a.	Commission and fees		
		PRE 2012 arrangements	POST 2012 arrangements	Total
	($'000)	($M)		
2013	187	3,380	0	**3,380**
2014	247	2,189	2,474	**4,663**
2015	241	1,832	2,770	**4,602**
2016	236	1,468	3,035	**4,503**
2017	233	1,084	3,286	**4,370**
2018	231	668	3,520	**4,188**
2019	232	329	3,736	**4,065**
2020	235	106	3,932	**4,039**
2021	244	84	4,111	**4,195**
2022	251	67	4,280	**4,347**
2023	259	53	4,452	**4,505**
2024	267	42	4,620	**4,663**
2025	276	34	4,790	**4,824**
2026	284	27	4,959	**4,985**
2027	276	21	5,123	**5,144**

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

The total commission and fees in Table 9 and Table 10 can be compared with the total commission and fees in Table 6 and Table 7. However, the breakdown of commissions by type of product in Table 6 and Table 7 is not available after the regulatory change (Table 9 and Table 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 – 30 June	Business volume			
	Risk insurance	Superannuation business	Managed investments	Total investment business
	APIUA in $M	FUA in $M		
2013	6,987	265,284	105,588	**370,872**
2014	7,699	284,517	129,589	**414,106**
2015	8,327	307,105	154,829	**461,934**
2016	9,025	333,653	180,729	**514,381**
2017	9,826	364,517	206,373	**570,890**
2018	10,701	400,095	227,308	**627,404**
2019	11,650	438,905	244,561	**683,466**
2020	12,678	480,768	260,857	**741,625**
2021	13,715	524,782	295,319	**820,101**
2022	14,787	571,222	334,324	**905,546**
2023	15,984	619,718	374,718	**994,435**
2024	17,251	670,192	419,999	**1,090,190**
2025	18,624	722,898	470,759	**1,193,657**
2026	20,084	776,719	527,665	**1,304,384**
2027	21,611	832,370	591,439	**1,423,809**

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

Comparing Table 6, Table 7, Table 8 and Table 9, we estimate that the key impacts of the regulatory change will be as follows:

- Total adviser remuneration will be broadly unchanged in the fifth year after the introduction of the new regulations (i.e. the year to 30 June 2018) and reduce by $1 billion in the 15th year after the change (in 2012 dollars). This includes fee income for the provision of scaled advice.
- A bring-forward of fee revenue associated with a movement towards fee for service charging is likely to result in a 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 (slightly decrease by 4% over the period to 30 June 2027). While the number of full service advisers will decline from approximately 17,750 to an estimated 14,900 in 2027, this will be offset by an additional 2,700 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 $3.5 billion) in 2012/2013 to 0.27% of GDP (or $8.0bn) in 2026/2027. If the regulatory change does not occur, total commission and fees paid will increase to 0.36% of GDP ($10.7bn) in 2026/2027. 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
- 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 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.

Table 12 and Table 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. Numbers 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
2012	17,746	350	**18,096**	636,639	160,364	**797,002**
2013	18,001	355	**18,356**	645,136	162,655	**807,791**
2014	18,241	360	**18,601**	650,997	164,945	**815,943**
2015	18,404	366	**18,770**	659,356	167,695	**827,050**
2016	18,639	372	**19,011**	670,316	170,444	**840,759**
2017	18,949	378	**19,327**	670,524	173,193	**843,717**
2018	18,949	384	**19,333**	679,333	175,942	**855,275**
2019	19,197	390	**19,587**	686,964	178,691	**865,654**
2020	19,411	396	**19,807**	691,438	181,440	**872,878**
2021	19,534	402	**19,936**	694,490	184,189	**878,679**
2022	19,616	408	**20,024**	694,698	186,938	**881,636**
2023	19,616	414	**20,030**	694,906	189,687	**884,593**
2024	19,616	420	**20,036**	695,114	192,436	**887,550**
2025	19,616	426	**20,042**	695,322	195,185	**890,508**
2026	19,616	432	**20,048**	695,426	197,935	**893,361**
2027	19,616	435	**20,051**	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 advisers	Number of piece of full advice	Number of piece of scaled advice	Total piece of advice
2012	17,746	350	**18,096**	636,639	160,364	**797,002**
2013	18,001	445	**18,446**	644,388	199,879	**844,266**
2014	18,293	579	**18,872**	652,068	265,080	**917,148**
2015	18,337	724	**19,061**	659,801	331,827	**991,628**
2016	18,218	873	**19,091**	667,327	399,943	**1,067,270**
2017	17,765	1,024	**18,789**	674,667	469,356	**1,144,023**
2018	16,928	1,178	**18,106**	681,799	539,946	**1,221,746**
2019	16,181	1,335	**17,516**	688,872	611,799	**1,300,672**
2020	15,687	1,495	**17,182**	695,983	684,962	**1,380,944**
2021	15,560	1,657	**17,217**	702,758	759,152	**1,461,910**
2022	15,470	1,821	**17,291**	709,317	834,348	**1,543,665**
2023	15,388	1,987	**17,375**	715,663	910,519	**1,626,181**
2024	15,287	2,156	**17,443**	721,846	987,670	**1,709,516**
2025	15,183	2,326	**17,509**	727,944	1,065,872	**1,793,816**
2026	15,066	2,499	**17,565**	733,757	1,145,050	**1,878,807**
2027	14,926	2,729	**17,655**	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 – after regulatory change

Scenario	The second year (2014/15)			The fifth year (2017/18)			The tenth year (2022/23)		
	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)
Base assumptions (see Section 7 above)	5,029	917,148	19,061	5,001	1,144,023	18,106	6,236	1,543,665	17,375
Advise fees 20% lower, usage of both full and scaled financial advice 20% higher	4,821	1,100,577	18,274	4,646	1,372,828	16,844	6,127	1,852,398	17,046
Advise fees 20% higher, usage of both full and scaled financial advice 20% lower	5,107	733,718	19,332	5,283	915,219	19,066	6,119	1,234,932	17,028
20% less usage of scaled financial advice in all years	4,967	864,132	18,743	4,933	1,050,152	17,743	6,170	1,376,795	16,968
20% less usage of full financial advice in all years	4,881	786,734	18,514	5,036	1,009,090	18,229	5,733	1,401,801	16,071

Scenario	The second year (2014/15)			The fifth year (2017/18)			The tenth year (2022/23)		
	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)
20% less usage of both full and scaled financial advice in all years	4,804	733,718	18,141	4,930	915,219	17,729	5,667	1,234,932	15,661
20% more usage of scaled financial advice in all years	5,088	970,164	19,369	5,066	1,237,895	18,467	6,302	1,710,534	17,785
20% more usage of full financial advice in all years	5,221	1,047,561	19,771	5,125	1,278,957	18,540	6,733	1,685,528	18,667
20% more usage of both full and scaled financial advice in all years	5,271	1,100,577	20,045	5,170	1,372,828	18,830	6,798	1,852,398	19,073
50% more new clients choosing to opt-in	5,070	917,148	19,213	5,101	1,144,023	18,457	6,429	1,543,665	17,877

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[22]
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.

[22] All dollar amounts are in 2012 dollars.

Appendix B Cost benefit analysis

A detailed cost benefit analysis of the FoFA reforms falls outside the scope of this report. However, given the impacts on adviser remuneration (client fees) and industry estimates of the costs, it is possible to provide a high-level analysis.

A cost benefit analysis allows the benefits and costs over the short, medium and longer term to be compared on an equivalent basis to assess the value of the reforms.

The benefits and costs of the regulatory reforms have been determined as follows:

- The gross **benefits** from the reforms consists of the projected reduction in adviser remuneration (client fees), adjusted to reflect the pass through of half the costs of FoFA (both implementation and ongoing) to customers. See below for details.
- The **costs** of FoFA implementation including; systems changes to grandfather commissions, implement fee for service charging, client fee disclosures and training, including compliance with regulations covering the provision of scaled advice and the best interests duty; are assumed to be in the range of $350 million to $700 million with ongoing costs between $187.5 million to $375 million in current dollar terms.

The compliance cost estimate range reflects 'whole of industry' estimates by the Financial Services Council following a survey of its members[23] and early evidence of operational provisions disclosed by AMP, BT, and MLC to shareholders and the media[24]. These reported costs have not been independently verified by Rice Warner but, given that they have been the subject of shareholder and public disclosure, they represent a reasonable basis for what the total compliance cost range may be. Rice Warner has previously provided initial estimates of the marginal cost on the opt-in provisions. However, this constitutes only a small part of the overall cost of the FoFA reforms.

It is important to note that consumers' net benefits are apparent early in the reforms; however, the purpose of this cost benefit assessment is to compare consumer benefits to the costs also borne by the industry and its shareholders.

On this basis, assuming costs and benefits are discounted at a rate of 7% per annum, the overall benefits to costs ratio (BCR) is estimated to be in the range of 1.7 to 2.9 over 15 years, depending on the actual compliance costs incurred. In the short term the benefits are lower, reflecting the delay before the full impact of the FoFA changes occur and the impact of grandfathering. For this reason it is appropriate to consider the BCR over the 15 year timeframe of this report and the savings objectives of the retirement income system.

It should be noted that this estimated BCR takes no account of the following which would tend to increase it further:

- The increased provision of advice which would directly improve savings such as the implementation of optimal contribution strategies to superannuation.

[23] Mr John Brogden, Parliamentary Joint Committee on Corporations and Financial Services, Hansard, 23 Jan 2012

[24] AMP Press Release, 16 August 2012, disclosed one off costs for FoFA, Stronger Super, and other regulatory changes between $60 million to $75 million. MLC's submission to the Parliamentary Joint Committee on Corporations and Financial Services estimated ongoing fee disclosure will have a one off cost of $3 million to $6 million and an ongoing cost of $0.5 million per annum. BT has disclosed its FoFA preparations have cost "tens of millions of dollars" (http://www.moneymanagement.com.au/news/warren-dunne-bt-fofa-compliance-costs-in-millions). Both BT and AMP's disclosures appear to be of the same quantum with each holding around 20 percent market share. If their costs were replicated across the industry it would imply up front compliance costs of $300 million to $350 million which is half of the FSC estimate.

- Stated implementation costs which also capture product and business process rationalisation which would otherwise have been incurred as a separate project. We are aware of a number of instances where, for convenience, business rationalisation initiatives have been captured under the organisation's regulatory reforms change project.
- The impact of any additional net investment returns driven by merit based product selection.
- The long-term impact of higher superannuation fund balances on the cost, to government, of the Age Pension.

Table 16 sets out the rationale for the key assumptions supporting the BCR calculation.

Table 16. Rationale for assumptions

Assumption	Rationale
FoFA costs	A detailed cost analysis has not been carried out. Costs have been assumed to be in the range of $350 to $700 million upfront and $187.5 to $375m ongoing based on an industry survey by the FSC and shareholder and media disclosures by affected institutions, as discussed above. Informal feedback from industry participants suggests that the cost estimates may be over-stated as, in some cases, there is a blurring of the distinction between FoFA and Stronger Super which has tended to lead to some of the latter being included in the former.
50% of the FoFA costs are passed through to consumers	Because demand for financial advice is elastic, it is assumed the costs of implementation and compliance will be split between customers and institutions (and their shareholders). It is assumed that market forces will lead institutions to find savings to fund half the FoFA costs. The net change in customer fees (pre and post reform) is adjusted to reflect this benefit. There is already evidence that reductions in operating and investment management costs have been driven by the reforms. An example is the launch of low cost superannuation products by the major wealth managers. In part, this is driven by a move to indexed investment. However, it also reflects genuine cost savings (and, to some extent, reduced margins for product providers).
Discount rate of 7% per annum	For this purpose, the benefits have been measured in nominal dollar terms. The discount rate reflects a risk-free rate plus a margin for uncertainty. The overall rate of 7% per annum strikes a balance between the uncertainty surrounding longer term cash flows and the need to make appropriate allowance for the benefits which, due to grandfathering and other factors, tend to emerge later in the projection period.

Using the central assumptions noted in Table 16 the net present value (NPV) of benefits and costs and the benefit cost ratio (BCR) is shown in Table 17.

Table 17. Benefit Cost Ratio estimate (range)

	NPV Benefits (A)	NPV Costs (B)	BCR (A/B)
	($M)		
Compliance Costs = $375 million upfront plus $187.5 million ongoing	6,749	2,368	2.9
Compliance Costs = $700 million upfront plus $375 million ongoing	7,933	4,735	1.7

The BCR is most sensitive to the estimate of implementation and compliance costs. For example, if the actual implementation and compliance costs are in line with shareholder and public disclosures by major institutions rather than industry association estimates the benefits outweigh the costs almost three times over 15 years rather than one-and-a-half times.

It is acknowledged that there is a degree of uncertainty regarding the selected assumptions. For this reason, Table 18 shows the sensitivity of the BCR results to changes in these key assumptions.

Table 18. Sensitivity of benefits to costs ratio

Discount rate	3%	5%	7%	9%
Base case: ▪ FoFA costs $700m implementation, $375m ongoing ▪ Benefits through cost savings used to fund FoFA changes: 50% of FoFA costs	2.0	1.9	1.7	1.5
Base case: ▪ FoFA costs $350m implementation, $187.5m ongoing ▪ Benefits through cost savings used to fund FoFA changes: 50% of FoFA costs	3.6	3.2	2.9	2.5
Base case: ▪ FoFA costs $700m implementation, $375m ongoing ▪ Benefits through cost savings used to fund FoFA changes: 0% of FoFA costs	1.5	1.4	1.2	1.0
Base case: ▪ FoFA costs $350m implementation, $187.5m ongoing ▪ Benefits through cost savings used to fund FoFA changes: 0% of FoFA costs	3.1	2.7	2.4	2.0