Institute of Actuaries of Australia

Role of Advisers within the Financial Services Market – Lynchpin or Leech?

Prepared by Andrew McKee

Presented to the Institute of Actuaries of Australia
5th Financial Services Forum
13 – 14 May 2010
Sydney

This paper has been prepared for the Institute of Actuaries of Australia's (Institute) 5th Financial Services Forum.
The Institute Council wishes it to be understood that opinions put forward herein are not necessarily those of the Institute and the Council is not responsible for those opinions.

The Institute of Actuaries of Australia
Level 7 Challis House 4 Martin Place
Sydney NSW Australia 2000
Telephone: +61 2 9233 3466 Facsimile: +61 2 9233 3446
Email: actuaries@actuaries.asn.au Website: www.actuaries.asn.au

Abstract

The purpose of this paper is to provide actuaries with a greater understanding of the impact of financial advice on individuals, on the financial services market and the broader economy.

A combination of complexity and materiality generates demand for advice:

- Australia has a complex legislative and financial services environment. This complexity means that the difference between making an informed decision and making a poor decision (or no decision) can mean many thousands of dollars for individual consumers.
- An individual will take a more active interest in their financial arrangements when they feel a decision is material to their financial wellbeing. It is this materiality that breaks an individual's inertia and leads them to seek advice.

Financial advisers are able to add value to individuals through tangible financial benefits as well as intangible benefits, such as peace of mind.

In addition, financial advisers add value to the financial services market and the overall economy by:

- increasing GDP
- increasing the efficiency of capital markets
- increasing the level of competition in financial services.

Actuaries can play an active role in the development of the financial advice industry through their roles as advocates, product manufacturers and risk specialists.

Keywords: Andrew McKee; financial advice; financial adviser; financial planner; financial planning; value; demand for advice;

1. Financial Advice Market

1.1 The Evolution of Advisers

Manufacturers of financial services products have traditionally considered financial advisers as a distribution channel for their products. This perspective owes an historical legacy to the agency system of distributing life insurance products prior to the introduction of the Financial Services Reform Act (FSRA) in 2002. Under the pre-FSRA system, the agent was acting as a representative of the product manufacturer and it is understandable that they were primarily considered as product distributors.

Since the introduction of the FSRA, the role of financial advisers has shifted from product distributors to client advisers. In 2008 Martin Mulcare discussed different adviser value propositions in his paper "The Personal CFO: An Alternative Model of Financial Advice." In this paper he advocated a new or emerging adviser value proposition: *"I am an expert in helping you achieve your financial goals and aspirations"*.[1] This is a much broader role than acting as a product distributor.

1.2 Size of Market

The number of financial advisers in Australia is approximately 15,000.[2] The Financial Planning Association of Australia (FPA) represents 9,000 practising financial planners.[3] The Association of Financial Advisers (AFA) represents 1,100 financial advisers.[4]

Galaxy Research in a report prepared for the FPA in May 2008 estimated that 30% of Australians currently use a financial adviser.[5]

In February 2008 the FPA released a report on the "Value of Advice" prepared by Rice Warner Actuaries (Rice Warner). The report estimated that the cost of advice varies depending on the type of advice – ranging from $250-500 for basic advice to $1,500-$20,000 for annual full service advice.[6] For annual advice Rice Warner assumed remuneration of a 0.6% pa on assets under advice.[7]

There is limited publicly available information regarding total financial planning revenue – ie revenue related directly to advice, as opposed to product and administration revenues. The following estimate has been derived from a range of unrelated (and potentially inconsistent) assumptions, but provides a guide to the size of the financial planning market. Total **recurring** financial planning revenues are estimated to be in the order of $1.0-1.5 billion, based on the following assumptions:

- an average investment balance of $42,559 for people with a financial adviser,[8]
- 30% of Australians currently using a financial adviser,[9]
- 17.8 million people aged 15 and over,[10]
- average annual advice remuneration of 0.6% pa on assets under advice.

This equates to recurring revenues of $66,000-$100,000 per financial adviser based on the estimated 15,000 financial advisers in Australia, which seems like a reasonable approximation. In addition financial advisers may also earn initial advice fees, contribution fees and insurance commissions.

It also equates to approximately 300-400 clients per financial adviser with each client paying ongoing advice fees of $250-$350 pa. This figure masks significant differences between adviser business models, with some financial advisers focused on high volume, low value clients and others focused on low volume, high value clients.

2. The Advice Burden

"Compare the pair" – Industry Fund Services Advertising Campaign

2.1 The Hidden Cost to Consumers

Advertising by the Industry Super Funds has portrayed the cost of advice as an unnecessary additional burden on the retirement savings of ordinary Australians. All costs within the financial services sector, including advertising costs, are ultimately borne by the end consumers of those services.

Many financial service products include advice remuneration within the bundled cost of the product. A proportion of the estimated $1.0-1.5 billion in recurring financial planning revenues are funded via these bundled costs. It is likely that some consumers of these bundled products will be paying for advice without receiving any explicit ongoing advice service. A consumer in this position may feel aggrieved by the advice industry and sympathetic with the advertising position of the Industry Super Funds. In other words, they may feel that financial advisers are an unnecessary additional burden on their savings – a burden that they haven't actively chosen.

Importantly, manufacturers are increasingly producing products that either allow advisers to dial-up or dial-down advice remuneration, or create a distinct (and disclosed) advice fee within the product, or exclude advice remuneration entirely. The Investment and Financial Services Association (IFSA) and the FPA have both endorsed a shift to fee for service remuneration structures for advisers, which will provide added impetus for manufacturers to produce products with unbundled fee arrangements. Over time this should ensure that all advice remuneration is explicit and that consumers have the ability to turn-on or turn-off advice.

2.3 The Consumer's Viewpoint – Not Using an Adviser

A survey conducted by Galaxy Research in May 2007 for the FPA identified the following reasons why people claim they do not use a financial adviser:

- 56% do not need financial advice
- 39% don't have enough money to make it worthwhile
- 21% believe it will cost too much
- 18% don't know where to find a good planner
- 11% believe financial planning is only relevant for retirement planning.[11]

Rice Warner in their Value of Advice report released in February 2008 stated that the cost of delivering advice is relatively high and prohibitive for the average Australian.[12]

While it is not stated in the above findings, there may also be another factor why some people do not use a financial adviser – lack of trust. Clients must trust their financial adviser to provide recommendations that are sound and impartial. Often this trust is based on the development of a personal and professional relationship between individual clients and financial advisers. However, notwithstanding the potential benefits that might accrue from receiving good quality advice, there are many consumers who do not trust the advice industry and as a result are unlikely to seek advice.

3. The Value of Advice

"Price is what you pay. Value is what you get." – Warren Buffett

3.1 Definition of Value

For a rational consumer of advice services, value is achieved when the expected benefits of advice outweigh the expected costs of advice.

3.2 Costs of Advice

In many cases, the costs of advice are easier for prospective consumers to determine than the potential benefits. Before giving personal advice a financial adviser must provide the prospective client with a Financial Services Guide that includes a summary of their remuneration (ie fees and commission). Prior to producing a Statement of Advice the financial adviser and client usually agree (often in writing) how the adviser will be paid for this Statement of Advice. Lastly, the Statement of Advice must provide details of the financial adviser's upfront and ongoing remuneration if the recommendations are implemented.

3.3 Adding Value

The potential benefits of advice are difficult for consumers to determine given the complexity of Australia's social security, superannuation and taxation systems. In 2006 Richard Cornwell identified the following areas where an adviser can add value to a client:

- Goal Setting
- Budgeting
- Superannuation
- Tax
- Government Benefits
- Risk Profile
- Gearing
- Diversification
- Fund Selection.[13]

3.4 Value of Advice – FPA Research

The FPA commissioned Rice Warner to undertake a review of the value of obtaining financial advice and of acting on recommendations from a financial adviser. The outcomes of the review are set out in Rice Warner's Value of Advice report released in February 2008. The FPA provided Rice Warner with several real life examples of financial advice. The report defined the value created by advice as the present value of total increase in wealth over the client's planning horizon (ranging from 4 years to 30 years). In summary, the value created for each of the examples was:

- A young family building wealth – more than $300,000 value created
- A wealthier family building wealth – more than $600,000 value created
- A low income plan – more than $100,000 value created
- Pre-retirement plan – more than $50,000 value created
- Pre-retirement inheritance – more than $100,000 value created
- A retired Nurse – more than $100,000 value created
- A family in need – approximately $50,000 value created
- Post-retirement inheritance – almost $200,000 value created.[14]

In all cases the value added was significantly more than the cost of advice. The combined value created for the 8 case studies was $1.7m (or over $200,000 on average).

3.5 Tangible Value Creation – Case Studies on Approaching Retirement

The following are real life case studies that demonstrate the value of strategic advice for people approaching retirement.

Kevin and Julia

Kevin aged 60, working part earning $30,000 pa, $100,000 available in bank, $600,000 in super
Julia aged 55, working full time earning $80,000 pa, $80,000 available in bank, $72,000 in super

Benefits of recommendations – annual benefits

Strategy	**Kevin**	**Julia**
Julia to salary sacrifice to maximum allowable level: Benefit = net gain on tax	$0	$7,062
Kevin and Julia to commence Transition to Retirement Account Based Pensions: Benefit = reduced tax on account based pension earnings versus super accumulation earnings *	$8,400	$1,824
Non concessional contribution of available bank balance: Benefit = reduced tax on cash earnings **	$75	$660
Government co-contribution: Benefit = estimated co-contribution	$1,000	$0
TOTAL	**$9,475**	**$9,546**

* based on 0% tax on account based pension earnings versus 15% on super earnings, with an earning rate of 8%.
** based on Julia's marginal tax rate of 30% and Kevin's marginal tax rate of 15% plus medicare levy versus 15% on super earnings, with a cash earning rate of 5%

Tony and Julie

Tony aged 56, working full time earning $130,000, $200,000 in super
Julie aged 56, working part time earning $33,000, $60,000 in super

Benefits of recommendations – annual benefits

Strategy	**Tony**	**Julie**
Tony to salary sacrifice to maximum allowable level: Benefit = net gain on tax	$9,383	$0
Tony and Julie to commence Transition to Retirement Account Based Pensions: Benefit = reduced tax on account based pension earnings versus super accumulation earnings *	$2,400	$720
Julie to make non-concessional contribution to qualify for co-contribution: Benefit = estimated co-contribution	$0	$950
TOTAL	**$11,783**	**$1,670**

* based on 0% tax on account based pension earnings versus 15% on super earnings, with an earning rate of 8%.

3.6 Value of Life Insurance

Where a claim is made under a life insurance policy (or any insurance policy), the benefit to that individual or family is clear.

However, many people will not actually make a claim on their insurance policy. The benefits of insurance are primarily in the pooling of risks – a principle well understood by actuaries. For individuals who do not make a claim, the benefit of life insurance is primarily the peace of mind that their wealth and the wealth of their family are protected against the adverse financial implications of death, disability or serious illness. For existing policyholders we can assume that the value of this peace of mind outweighs the cost of the insurance premium.

3.7 The Consumer's Viewpoint – Using an Adviser

In May 2007 the FPA released a report on the "Consumer Attitudes to Financial Planning" prepared by Galaxy Research.[15] The research reported that 89% of Australians who have used a financial adviser benefited from the experience, with the key benefits stated as follows:

- 66% greater peace of mind
- 63% greater control of finances
- 62% prospect of a more comfortable retirement
- 54% avoiding bad investments
- 47% following a budget
- 46% ability to save more

The Galaxy Research report also noted from their survey results that the most important elements of a client's relationship with a financial adviser are:

- 82% say their adviser is knowledgeable about a range of issues
- 80% say they can trust their adviser
- 74% say they can reach their adviser when they need something
- 70% say their adviser puts their interests first.

Importantly, many of these benefits are intangible. The value of peace of mind is hard to determine for individuals and it is even more difficult to gauge the impact on the broader community. However, it is clear that clients who develop a strong relationship with their financial adviser often feel a strong sense of control and comfort that their financial affairs are being appropriately managed. This intangible benefit is a very important part of the value generated through a professional advice relationship.

3.8 Value of Advice – IFSA Research

In October 2009 IFSA released a report on the "Value Proposition of Financial Advisory Networks" prepared by KPMG Econtech (KPMG).[16] IFSA commissioned KPMG to investigate the impact of financial advice on individual savings behaviour and to undertake economic modeling to estimate the economy wide implications of this boost in savings.

The report estimated that:

- the average investment balance in 2007/08 for individuals with a financial adviser was $42,559 versus $34,346 for individuals without a financial adviser.
- the average savings balance in 2007/08 for individuals with a financial adviser was $6,991 versus $4,341 for individuals without a financial adviser.

After adjusting for other factors that may influence savings behaviour, the report concluded that an individual with a financial adviser is estimated to save an additional $2,457 in a year compared to similar individuals without financial advisers.

4. Value Equation for Individual Consumers

"There are two levers to set a man in motion, fear and self-interest." – Napolean Bonaparte

4.1 Value Equation

Rational consumers will seek advice when:

- they are able to make a **choice** about their financial arrangements, and
- they are not confident of making appropriate choices given the level of **complexity**, and
- they believe that the **materiality** of making appropriate choices will outweigh the cost of advice.

4.2 Choice

Choice is not an essential part of a retirement financing system. Singapore is an example of a developed country that offers limited choice in retirement savings. Singapore operates the Central Provident Fund which is a comprehensive and compulsory retirement savings, health and social security scheme.

Australia has a mandated superannuation contribution approach and only introduced choice of superannuation fund for employees in 2005.

Notwithstanding this ability to choose their superannuation fund, the vast bulk of Australians do not exercise any choice. Most Australians remain with their employer's default fund, in the fund's default investment option, with the fund's default insurance cover. In September 2009, the Australian Institute of Superannuation Trustees (AIST) noted that more than 80% of super fund members were in a default investment option. In addition, the survey results released by the AIST showed that less than 6.5% of super fund members changed their investment strategy within a 3 year period to June 2009.[17] There is a level of inertia in Australian consumers when it comes to making active decisions regarding their financial planning.

However, the number of financial advisers in Australia provides some indication that when an individual's retirement is approaching or their superannuation balance is becoming significant, then they want the ability to make a choice.

If an individual doesn't make a choice, then that choice needs to be made either by their employer, their trade union, their superannuation fund or the government. At the moment many Australians are making a passive decision to allow their employer and their superannuation fund to make retirement savings choices for them.

Whether choice is being made passively (via an employer or superannuation fund) or actively, the Australian market provides the opportunity for individual's to make a choice. It is not clear how Australian voters would react if a government was to seek to limit or control the availability of choice.

4.3 Complexity

The Australian tax system and financial services market have developed over many years and include substantial complexity, such as:

- Different tax regimes for individuals, companies, trusts, superannuation and pensions
- Complex tax rules such as capital gains tax, GST, dividend imputation, withholding tax, HECS, etc
- Restrictions on contributions to superannuation
- Restrictions on accessing superannuation benefits
- Unbundled investment market, where individuals need to make separate choices regarding administration platforms and investment management
- Choice of superannuation fund, with significant differences between funds regarding investment options (ranging from a few options to many hundreds of options), insurance options and costs
- Unbundled insurance market, where individuals need to make separate choices regarding their life, total and permanent disablement cover, trauma cover, and income protection cover, as well as their health and general insurance
- Social security entitlements depend on many factors including an income and assets tests for the Age Pension
- Choice of debt arrangements including mortgages, investment loans, personal loans, credit cards, fixed versus variable interest rates, as well as many other consumer finance arrangements (cars, mobile phones, interest free periods, etc)
- Complex aged care system, with funding dependent on the standard of care required, standard of accommodation, and the income and assets of the recipient.

With the current reviews into Australia's advice, superannuation and tax systems it is likely that this complexity will continue in the years ahead.

As a result of this complexity the difference between making an informed decision and making a poor decision (or no decision) in the Australian market can mean many thousands of dollars for individual consumers.

In addition, different people in very similar circumstances may require quite different advice recommendations due to individual preferences including:

- Risk tolerance – some individuals are risk adverse with respect to their investments (and their overall financial affairs) while others are happy to take on additional risk for the prospect of additional long term returns.
- Insurance needs – some families would adjust their lifestyle and future goals if they suffered disability or death of a partner, while other families want greater future security.
- Income protection – some people have enough resources (or access to family support) to survive a longer waiting period whereas others require a short waiting period.
- Retirement needs – some people expect to manage on a smaller income once they retire while others expect to maintain (or extend) their lifestyle in retirement.
- Testamentary intent – some people may want to leave a legacy for their children or to a charity, whereas others are comfortable with depleting their assets during retirement

In other words, there is no "one-size-fits-all" approach. The key conclusion from the earlier case studies is that in an environment with significant complexity and choice, financial advisers can assist their clients with recommendations that produce tangible benefits of many thousands of dollars.

4.4 Materiality

Material – "of substantial import or much consequence" – The Macquarie Dictionary Online

The materiality of specific financial decisions is largely dependent on an individual's subjective judgment, and will vary considerably over time. Materiality for an individual will depend on many factors including:

- Age
- Accumulated Wealth
- Proximity to retirement (ie proximity to superannuation and social security)
- Income
- Surplus cashflow
- Debt position
- Family circumstances
- Health

An individual will take a more active interest in their financial arrangements when they feel a decision is (or a set of decisions are) material to their financial wellbeing. It is this materiality that breaks an individual's inertia and leads them to seek advice so they can make active decisions regarding their financial planning.

An individual aged between 20-30 will not be particularly interested in their superannuation which cannot be accessed until they are age 60 based on the current rules (and there are no guarantees these rules will continue to apply for the next 30-40 years). Whereas an individual with less than 5 years to retirement will be extremely interested in their superannuation as the ability to access these funds is becoming imminent.

The Galaxy Research report prepared for the FPA in May 2008 identified that the use of financial advisers increases with age, with the following percentages of people using financial advisers ongoing or occasionally:

- 16-24 years – about 10%
- 25-34 years – over 25%
- 35-49 years – over 30%
- Over 50 years – over 35% [18]

To illustrate how this materiality can drive decisions, the following chart shows a number of basic client types and a hypothetical materiality for different types of advice:

Type of advice	Single, aged < 30	Young family, aged 30-40	Older family, aged 40-50	Pre-retiree, aged 50-65
Retirement Finances	○	◔	◑	●
Insurance – life cover	○	●	◕	◔
Insurance – income cover	◕	●	◕	◔
Budgeting / debt mgt	●	◕	◑	◔

Note: white ball = lowest materiality, black ball = highest materiality

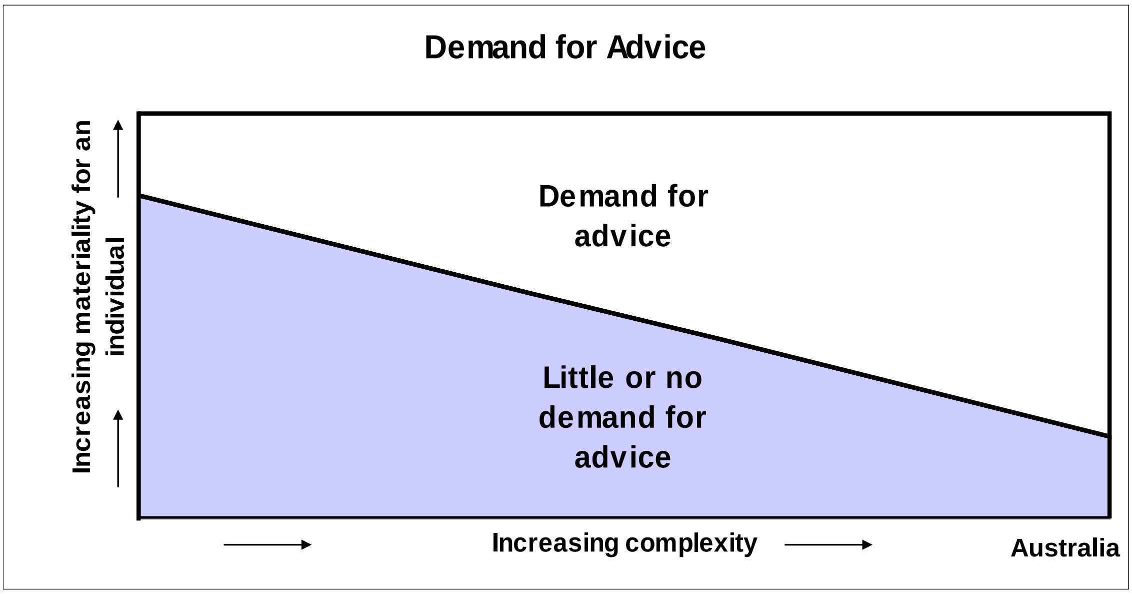
4.5 Demand for Advice

The decision to seek advice – and as a corollary why demand has driven the development of a financial planning market in Australia – is dependent on the complexity of the system and the perceived materiality for the individual.

Where there is less complexity (or less opportunity to make a choice), there will be less demand for advice – for example, when there are no tax differentials between different structures (individual, companies, trusts, superannuation, pensions).

Where there is less materiality, there will be less demand for advice – for example, when people have limited investment assets or access to their superannuation is many years away, then they are unlikely to be actively engaged in the management of their financial affairs.

The following chart provides an indication on the relationship between complexity and materiality. While accumulated wealth is a key factor in materiality, and hence the vertical axis below, it is not the only factor impacting materiality. In less complex environments an individual's materiality needs to be higher to generate demand for advice compared to complex environments. Whereas in complex environments, like Australia, demand for advice will occur at lower levels of materiality.



Given Australia's complexity, it is not surprising that we have developed (and continue to develop) a financial advice market to satisfy the resulting demand for advice.

Different financial systems will result in different levels of demand for advice, for example:
- Universal pension – likely to result in lower demand for advice, especially if the pension is structured to provide a substantial level of retirement income.
- Less developed economies with less "advisable" wealth – likely to result in lower demand for advice.
- Uniform tax rules, eg no significant tax concessions for retirement savings – likely to result in lower demand for advice.

5. Alternatives

5.1 Other options currently available for people needing assistance with their finances

Within the current Australian market there are no alternative options for people needing comprehensive advice on their financial arrangements. There are a number of alternatives for people with specific needs, such as:

Centrelink – assistance regarding eligibility for Centrelink benefits such as Age Pension and Newstart Allowance

Advice within super – advice only on investment and insurance options within the specific super fund.

Accountant – tax advice only (unless also authorised to provide advice under an Australian Financial Services Licence); tax advice can include impact of concessional contribution levels to superannuation, but not advice on investment products or superannuation products.

Family and friends – although the advice provider may inadvertently open themselves to potential litigation/liability.

Financial press – general advice, not specific to an individual's personal circumstances.

Real Estate – direct property advice only.

Mortgage Brokers – arranging appropriate debt solutions.

Solicitors – legal advice only, but crucial for implementing estate planning.

6. Value of Advice – Economy

"It is not by augmenting the capital of the country, but by rendering a greater part of that capital active and productive than would otherwise be so, that the most judicious operations of banking can increase the industry of the country." – Adam Smith

6.1 IFSA Research

The "Value Proposition of Financial Advisory Networks" prepared by KPMG Econtech (KPMG) for IFSA in October 2009 concluded that the key economic implications of an extra 5% of Australians receiving advice are:

- 0.5% of GPD gain in national savings by 2014/15
- In the long run, foreign liabilities (ie foreign financing of domestic capital) are approximately 1.5% of GDP lower
- The lower reliance on foreign investment could lower the risk premium for investment in Australian, so gains in business capital are sustained in the longer term
- GPD is 0.6% higher in 2014/15 (ie after 6 years), supported by gains of 0.4% in business capital and 0.1% in employment.[19]

Using the above results, we can determine the average expected increase in GDP for each additional Australian receiving advice. Australia's GDP for the 12 months ended 31 December 2009 was approximately $1.2 trillion.[20] A GDP increase of 0.6% equates to an increase of $7.2 billion based on current GPD levels. The civilian population aged 15 and over in February 2010 was approximately 17.8 million.[21] If an extra 5% of Australians received advice, then there would be approximately 890,000 extra Australians receiving advice. Therefore the increase in GDP over the 6 years for each additional Australian receiving advice is estimated as $8,090.

6.2 Investment decisions – movement of capital from investors to productive institutions

A key part of a financial adviser's role is to make investment recommendations to clients. These recommendations have regard to the risk tolerance of the client as well as the investment risks of each individual investment and the accumulation or diversification of risk across the client's entire portfolio.

In making these recommendations, a financial adviser is effectively allocating capital from investors to an institution that requires capital, sometimes via a managed fund and sometime directly. Often these investment allocation decisions will depend on a comparison of the relative expected returns and the relative risks associated with each investment or investment sector.

While institutional investors play a crucial role in ensuring we have a competitive capital market, the recommendations of financial advisers also encourage a competitive capital market. It is unlikely that any individual financial adviser will make a material difference to capital allocations, but the combined actions of financial advisers does play an important role in allocating capital to various markets – for example domestic equities, international equities, domestic government bonds, international government bonds, semi-government securities, domestic corporate debt, international corporate debt, domestic banks via term deposits and short term fixed interest securities, plus many other sectors and sub-sectors.

By making recommendations – either directly or via a managed fund – financial advisers play an active role in improving competition between institutions seeking capital. Whether capital markets are efficient or not is outside the scope of this paper. However, by helping to increase competition in capital markets, financial advisers are improving the ability of individual consumers to access investments at a price that reasonably (although perhaps not perfectly) reflects the underlying expected risks and returns of that investment. Without strong competition in capital markets, consumers may inadvertently invest in mispriced investment opportunities.

6.3 Financial services competition

There are over 600 managed funds in Australia. It is very difficult for consumers to analyse the market and make an informed decision.

It is also very difficult for any individual financial adviser to analyse the breadth of offerings available. Financial advisers typically rely on research provided by their licensee or by an external researcher. There is considerable competition between external researchers in the Australian financial planning market. This competition means that researchers must offer cost-effective and comprehensive research to attract "clients" – in this case licensees or financial advisers. This research is typically not freely available to consumers.

Financial advisers recommend managed fund investments having regard to their available research. These recommendations will be based on a number of factors including:

- historical performance – defining "performance" in very broad terms including returns, volatility or risk, consistency of performance over time, likelihood that this performance will continue (eg stability of investment team, ownership, etc)
- costs, and
- correlation of returns between managers.

This decision making process for financial advisers helps ensure that the success of fund managers will depend on whether they are able to justify their costs in comparison with their performance and in comparison with other managers in the market. This competition is healthy for the financial services market, ensuring there is pressure on fund managers to deliver, with successful managers attracting inflows and unsuccessful managers suffering fund outflows. In other words, financial advisers act to ensure strong competition in the retail and wrap (or wholesale) funds management markets. Asset Consultants play a similar role in the institutional funds management market.

In the existing market structure, fund managers with strong investment processes but limited marketing support are able to compete with larger managers with significant marketing support. Without the financial adviser-research driven competition, there is the potential that the larger managers would dominate the market and make it difficult for new entrants to generate enough business. This could result in consumers either paying more for managed funds due to less active price competition or needing to accept lower quality managed funds (on average) due to less active performance competition.

The same argument applies to competition for insurance products, administration platforms (wrap accounts), superannuation funds and stockbroking services – that is, financial advisers help improve competition for these services.

6.4 Other potential benefits

Financial advisers may also benefit the broader economy through:

- Reducing the reliance of individuals and families on social security via retirement planning, life insurance and estate planning.
- Protecting the wealth of individuals and families by increased insurance coverage and properly implemented estate planning. This should also result in less reliance on the health and social security systems.

7. Conclusion

Consumers who are paying for advice within the bundled cost of a product and not receiving an advice service might understandably feel that the financial adviser is a "leech" on their savings.

However, where a consumer makes a choice to receive advice, and is happy to pay for that advice, in many cases there are clear benefits for the consumer – both tangible financial benefits as well as intangible benefits, such as peace of mind.

In addition to the benefits at an individual level, the advice market also provides value to the financial services market and the overall economy by:

- increasing GDP
- increasing the efficiency of capital markets
- increasing the level of competition in financial services.

Financial advisers are able to generate tangible benefits for consumers in Australia as a result of the complexity of our environment.

Notwithstanding this complexity, many Australians do not make active decisions on their financial arrangements. Many individuals will only take an active interest in their financial arrangements when they feel a decision is material to their financial wellbeing. It is this materiality that breaks an individual's inertia and leads them to seek advice.

The combination of complexity and materiality generates demand for advice, and therefore ensures that financial advisers are, and will remain, a crucial and valuable "lynchpin" in the financial services market.

8. Role of Actuaries

If we accept the position that advisers have the ability to add value to individuals, the financial services market and the economy, how can actuaries play an active role in encouraging and supporting the advice market?

Actuaries as advocates:
- Encourage policy decisions that support the ongoing development of the advice industry
- Encourage policy decisions that increase the accessibility/affordability of advice

Actuaries as product manufacturers:
- Develop products/pricing to help manage the shift from commission to advice fees
- Develop approaches for managing the trade-off between the high initial cost of advice and affordability.

Actuaries as risk specialists:
- Assist advisers/licensees with cost-effective tools to understand and manage risk, such as investment risk (eg stress testing), accumulation risks, and the risk of mis-matching retirement liabilities and retirement assets (eg longevity risk, inflation risk, liquidity risk).

Actuaries in the community:
- As financial experts many actuaries find themselves providing pro-bono advice to family and friends, although they may not fully understand all the rules and regulations. The ability to confidently recommend an adviser to family and friends would reduce the potential liability of providing personal advice.
- Actuaries may also benefit as consumers of advice, saving themselves time and effort.

Actuaries as advisers
- Many actuarial skills can be applied when providing advice to clients, and I believe it is likely that increasing numbers of actuaries will become advisers.

- **References**

[1] Mulcare M, 2008, *The Personal CFO: An Alternative Model for Financial Advice*, The Institute of Actuaries of Australia

[2] KPMG Econtech Report, 2009, p.11, *Value Proposition of Financial Advisory Networks*, prepared by KPMG Econtech for the Investment & Financial Services Association.

[3] Financial Planning Association website, 2010, *Profile, Vision and Priorities:* http://www.fpa.asn.au/FPA_Content.aspx?Doc_id=1027, Financial Planning Association

[4] Association of Financial Advisers website, 2010, *Corporate Profile*: http://www.afa.asn.au/documents/mediacentre/mediareleases/AFA_corporateBrochure_2007.pdf, Association of Financial Advisers

[5] Galaxy Research Report, 2008, p.3, *Financial Planning in a Volatile Economic Environment*, prepared by Galaxy Research for the Financial Planning Association

[6] Rice M, 2008, p.5, *Value of Advice*, prepared by Rice Warner Actuaries for the Financial Planning Association

[7] Rice M, 2008, p.7, *Value of Advice*, prepared by Rice Warner Actuaries for the Financial Planning Association

[8] KPMG Econtech Report, 2009, p.6, *Value Proposition of Financial Advisory Networks*, prepared by KPMG Econtech for the Investment & Financial Services Association.

[9] Galaxy Research Report, 2008, p.3, *Financial Planning in a Volatile Economic Environment*, prepared by Galaxy Research for the Financial Planning Association

[10] Reserve Bank of Australia, 2010, *Statistical Tables – g07hist*, RBA website address http://www.rba.gov.au/statistics/tables/xls/g07hist.xls, (data derived from ABS Cat No 6202)

[11] Galaxy Research Report, 2007, *Consumer Attitudes to Financial Planning*, prepared by Galaxy Research for the Financial Planning Association

[12] Rice M, 2008, p.4, *Value of Advice*, prepared by Rice Warner Actuaries for the Financial Planning Association

[13] Cornwell R, 2006, *The Value of Advice: The Financial Adviser, Value Creation and Remuneration*, The Institute of Actuaries of Australia

[14] Rice M, 2008, p.8, *Value of Advice*, prepared by Rice Warner Actuaries for the Financial Planning Association

[15] Galaxy Research Report, 2007, *Consumer Attitudes to Financial Planning*, prepared by Galaxy Research for the Financial Planning Association

[16] KPMG Econtech Report, 2009, p.6, *Value Proposition of Financial Advisory Networks*, prepared by KPMG Econtech for the Investment & Financial Services Association

---

[17] Australian Institute of Super Trustees Media Release, 17 September 2009, *Member inertia highlights importance of Super Fund Default Design*, Australian Institute of Super Trustees

[18] Galaxy Research Report, 2008, p.3, *Financial Planning in a Volatile Economic Environment*, prepared by Galaxy Research for the Financial Planning Association

[19] KPMG Econtech Report, 2009, p.3, *Value Proposition of Financial Advisory Networks*, prepared by KPMG Econtech for the Investment & Financial Services Association IFSA KMPG

[20] Reserve Bank of Australia, 2010, *Statistical Tables - g10hist*, RBA website address http://www.rba.gov.au/statistics/tables/xls/g10hist.xls, (data derived from ABS Cat No 5206)

[21] Reserve Bank of Australia, 2010, *Statistical Tables – g07hist*, RBA website address http://www.rba.gov.au/statistics/tables/xls/g07hist.xls, (data derived from ABS Cat No 6202)