Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Additional Estimates 2012

15 – 17 February 2012

Question: AET 1287

Topic: The cost estimate of implementation of FOFA across the industry

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Senator Cormann asked:

You put into your draft RISs the research from the Industry Super Network. The Financial Services Council said that the cost of implementation of FOFA across the industry would be $700 million upfront and $350 million ongoing. Are you aware of that cost estimate?

Mr Murphy: I am aware of it. As I am advised, people put forward various estimates of the impact of regulation, especially costs and the like. We saw that recently from major banks. We have to examine that. We listen, hear what they are saying and ask for their material. We then examine it to see their underpinning assumptions and how they have costed it. I am very sceptical of that estimate.

Senator Cormann: Have you examined it?

Mr Murphy: We are examining it.

Senator Cormann: You have not reached a conclusive view yet?

Mr Murphy: No, we have not, because these are their internal costings. As well as that, we look at what other people say. From what I can glean from all the various estimates that have come out, it is going to have a marginal impact on the financial planning industry. There will be a growth in certain businesses, and a diminution in a small fringe of businesses—that is, the people who probably do not wish to adapt to the new regime.

Senator Cormann: That is what the Industry Super Network commissioned research says.

Mr Murphy: I know, and I think there are others. Other statements have been made.

Senator Cormann: Like who?

Mr Murphy: Through the minister's office, I will get them.

Senator Cormann: Perhaps take that on notice.

Answer:

There have been a wide range of estimates of the cost impact that various FOFA measures will have on the financial advice industry.

As is the case with any significant structural reform, there will be transitional costs associated with the FOFA reforms. However, it is important to take into account the significant benefits to consumers that flow from making these changes when considering transition costs.

In this regard, the Future of Financial Advice reforms are about improving the quality of financial advice provided to consumers. In addition to recent high-profile collapses in the financial advice industry, there is consistent evidence of consumers receiving poor quality advice. A common cause of this poor quality advice is conflicts of interests faced by financial advisers because of their financial linkages to product providers. FOFA seeks to break these linkages and make the client, not the product, the focal point of the advice relationship.

The potential benefits to consumers of achieving this policy outcome are highly significant. Better aligning the interests of advisers and clients will result in higher quality advice, reductions in product fees and a more competitive advice industry. In addition, consumers will benefit from more engagement from financial advisers and the greater availability of advice.

In the broader context, factors like Australia's ageing population and increasing levels of superannuation are expected to result in an increase in demand for financial advice services and an increase in adviser numbers over the coming years. For example, many of Australia's major financial institutions including ANZ, Westpac and the National Australia Bank are reported to have indicated that they are planning to increase their adviser numbers in the next few years.[1] In addition, IBISWorld is forecasting industry revenue to grow by 7 per cent per annum and industry employment to grow by 4 per cent per annum in the five years through to 2016-17.[2] These positive developments/forecasts are inconsistent with the notion that the reforms will have a severe and deleterious cost impact on the sector.

It is also important to bear in mind that the changes apply prospectively. In addition, the legislation allows for grandfathering arrangements that mean that many payments, even after the commencement of reforms, will not be impacted as long as they relate to an arrangement entered into before the commencement of the reforms. As a result, many costs occasioned by the reforms will only affect businesses gradually, as new clients sign on with firms or existing clients enter into new arrangements.

Finally, the Government has recently announced more flexible transition arrangements that result in firms having until 1 July 2013 before they are required to comply, unless they elect to adopt the reforms early. This provides firms with significant time in order to transition into the regime and make any necessary system changes.

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[1] Sally Patten, 'Advice a growth area', *The Australian Financial Review*, 6 February 2012, page 44.

[2] IBIS World Industry Report K7515, *Financial Planning & Investment Advice in Australia*, January 2012, page 39.