



KPMG ECONTECH

Value Proposition of Financial Advisory Networks

This report was prepared for the
Investment and Financial Services
Association

29 October 2009

ADVISORY

Inherent Limitations

This report has been prepared as outlined in the Engagement Letter from KPMG Econtech to the Investment and Financial Services Association (IFSA) dated 3 December 2008. The services provided in connection with this engagement comprise an advisory engagement which is not subject to Australian Auditing Standards or Australian Standards on Review or Assurance Engagements, and consequently no opinions or conclusions intended to convey assurance have been expressed.

In part the findings in this report are based on a qualitative study and the reported results reflect a perception of IFSA Financial Advisory Networks (FAN) members, but only to the extent of the sample surveyed, being IFSA's approved representative sample of IFSA FAN members. Any projection to the wider IFSA FAM membership is subject to the level of bias in the method of sample selection.

No warranty of completeness, accuracy or reliability is given in relation to the statements and representations made by, and the information and documentation provided by IFSA personnel or IFSA FAN members consulted as part of the process.

KPMG Econtech have indicated within this report the sources of the information provided. We have not sought to independently verify those sources unless otherwise noted within the report.

KPMG Econtech is under no obligation in any circumstance to update this report, in either oral or written form, for events occurring after the report has been issued in final form.

This report only takes into account information available to KPMG Econtech up to the date of this report and so its findings may be affected by new information.

The findings in this report have been formed on the above basis.

Forecasting Disclaimer

Any economic estimates in this report of the impacts of possible events hold all other factors constant. They also rely on economic parameters that are subject to unavoidable statistical variation.

Any economic projections or forecasts in this report rely on economic inputs that are subject to unavoidable statistical variation. They also rely on economic parameters that are subject to unavoidable statistical variation.

While all care has been taken to ensure that statistical variation is kept to a minimum, care should be taken whenever using this information.

Any estimates or projections will only take into account information available to KPMG up to the date of the deliverable and so findings may be affected by new information. Events may have occurred since we prepared this report which may impact on it and its findings.

Financial Advice Disclaimer

The information provided in this report does not constitute financial advice. The information is of a general nature only and is not a substitute for professional financial advice. No entity or individual should undertake or refrain from any action based on the information in this report without seeking specific financial advice from a professional adviser.

Third Party Reliance

The report has been prepared in accordance with the terms of KPMG Econtech's Engagement Letter dated 3 December 2008. The report is solely for the purpose set out in the scope section of KPMG Econtech Engagement Letter dated 3 December 2008 and is not to be used for any other purpose. Other than our responsibility to IFSA, neither KPMG Econtech nor any member or employee of KPMG Econtech undertakes responsibility arising in any way from reliance placed by a third party on this report. Any reliance placed is that party's sole responsibility.

We understand that this report may be released into the public domain. Third parties who access the report are not a party to our engagement letter with IFSA and, accordingly, may not place reliance on this report. Our engagement was neither planned nor conducted in contemplation of the release of the report to the public. Accordingly, any third party accessing the report acknowledges that it may not place reliance on the results and findings contained in the report. KPMG Econtech shall not be liable for any losses, claims, expenses, actions, demands, damages, liabilities or any other proceedings arising out of any reliance by a third party on this report.

Contents

Key Results:	3
Executive Summary	4
1 Introduction	9
2 Quality financial advice	10
2.1 What is an IFSA FAN?	10
2.2 The need and benefit of financial advice	11
2.3 The value of financial advice	12
2.4 Quality provided by an IFSA FAN	14
3 The value of quality financial advice	20
3.1 Approach to Valuing Financial Advice	20
3.2 Data	21
3.3 Descriptive Statistical analysis	22
3.4 Regression analysis	22
3.5 Economy-wide Modelling	23
4 The economic contribution of financial planners	26
4.1 Descriptive Statistics	26
4.2 Regression Analysis	27
4.3 Economy-wide Modelling	27
5 Key Findings	40
Appendix A – Survey Questions	42
Appendix B – MM2	46
Appendix C – Regression Results	48

Key Results:

The economy-wide modelling began with descriptive statistical analysis. The initial descriptive statistical analysis of the data indicate that those with a financial planner have greater savings and investment balances than those who do not. Notably, those with a financial planner have \$2,650 on average more than those without a planner (based on the level of contributions in the 2007/08 financial year). KPMG Econtech then undertook further analysis to control for other factors that may influence saving behaviour, such as, wealth, employment status and salary. The results of the regression analysis show that an individual that has a financial planner is estimated to save an additional \$2,457 in a year compared to similar individuals without financial advisors/planners.

Based on the analysis above, KPMG Econtech then undertook economy-wide modelling to estimate the impact of more Australians receiving financial advice. The additional saving by individuals receiving financial advice lifts household saving and hence national saving levels. Specifically, the key economic implications of an extra 5 per cent of Australians receiving financial advice are as follows.

- A 0.50 per cent of GDP gain in national saving by 2014/15 compared to what would otherwise be the case.
- The higher wealth of Australia, as a result of the increase in national saving, leads to less dependence on foreign financing of domestic capital. In the long run, foreign liabilities are approximately 1.5 per cent of GDP lower under the saving scenario.
- The lower reliance on foreign investment in this scenario could lower the risk premium for investment in Australia, so that gains in business capital are sustained in the longer term.
- Under the Increased National Savings scenario, GDP is 0.6 per cent above the baseline in 2014/15, supported by gains in business capital and employment of 0.4 per cent and 0.1 per cent, respectively.

KPMG Econtech developed a survey to analyse quality aspects of IFSA members on five categories, including: training and development; compliance and risk management; product knowledge and research; and consumer protection and client satisfaction. The main results of this survey is as follows.

- Product research and knowledge regulations were exceeded by all respondents.
- Eight of nine respondents exceeded regulatory requirements for training and development.
- Six of the nine respondents exceeded the regulatory requirements for consumer protection.
- Five out of nine respondents reported that they exceed current regulatory requirements in all five categories.
- All respondents exceeded regulatory requirements in at least one of the five categories.

Executive Summary

The Investment and Financial Services Association (IFSA) has a view that the provision of quality financial advice has the potential to provide consumers with a more appropriate wealth management strategy. That is, IFSA contends that good advice can lead to a reduction in risk through diversification and a better match between an individual's risk profile, based on factors such as age and risk tolerance, and their portfolio of assets. These factors, as well as the financial discipline which comes from having a financial planner, have the potential to lift the saving of an individual. Higher saving by individuals leads to gains in household saving and hence national saving; higher national saving has important economy-wide implications.

Within this context, KPMG Econtech was commissioned by IFSA to investigate the impact of financial advice on individual savings behaviour and to undertake sophisticated economic modelling to estimate the economy wide implications of this boost in savings. The economy-wide modelling does not consider the other implications of financial advice to the economy, such as the potential increased returns. To capture the wider implications, the rates of returns; associated risks; and the fees associated with the financial advice would need to be considered.

Importantly, the advice provided by financial advisors/planners varies in quality. In addition to estimating the economy-wide benefits of additional saving arising from financial advice, KPMG Econtech analysed the role of Financial Advisory Networks (FANs) in providing quality financial advice. Specifically, KPMG Econtech developed a survey to ascertain the measures taken by FANs to improve the quality of advice provided by their advisors/planners over and above those required by regulation. The survey covered quality indicators such as:

- training and development;
- compliance and risk management;
- product research and knowledge;
- consumer protection; and
- client satisfaction.

Table A below provides a summary of the responses received from IFSA FANs. The IFSA FAN members who responded to the survey represent approximately 38 per cent of advisers (or 5,600) in the top 100 Australian dealer groups. For statistical purposes, this is a large sample size from which robust inferences can be made.

Table A Summary of KPMG Econtech Survey Results - Quality Aspects									
Respondent	1	2	3	4	5	6	7	8	9
Training and Development	-	✓	✓	✓	✓	✓	✓	✓	✓
Compliance and Risk Management	-	-	✓	✓	✓	✓	✓	✓	✓
Product Research and Knowledge*	✓	✓	✓	✓	✓	✓	✓	✓	✓
Consumer Protection	-	✓	-	-	✓	✓	✓	✓	✓
Client Satisfaction^	-	✓	✓	-	✓	✓	✓	✓	✓

Source: KPMG Econtech Survey

✓ Indicates respondent exceeds regulations - Indicates respondent member meets regulations

*Responses recorded refers to Question 3a ^ Refers to whether or not respondent monitors client satisfaction

As can be seen from the summary table above, the majority of survey respondents reported that they currently exceed regulatory requirements in most categories. For example, as well as the regulations imposed on financial advisors/planners, eight out of nine IFSA FANs reported that they require their advisors/planners to complete further training and personal development activities. In addition, all respondents reported that they impose further requirements on product knowledge and research, ensuring those IFSA FAN advisors/planners have up to date knowledge and skills that are relevant to the provision of financial advice. In this way, IFSA FAN advisors/planners who responded to the survey are held to a higher standard than regulation requires.

IFSA FAN advisors/planners are required to pass compliance and risk checks throughout the year on a regular basis. Authorisation under the licence is based on compliance with these additional levels of qualifications. Specifically additional qualifications are required to provide advice for certain areas including gearing, self managed super funds (SMSF) and reverse mortgages.

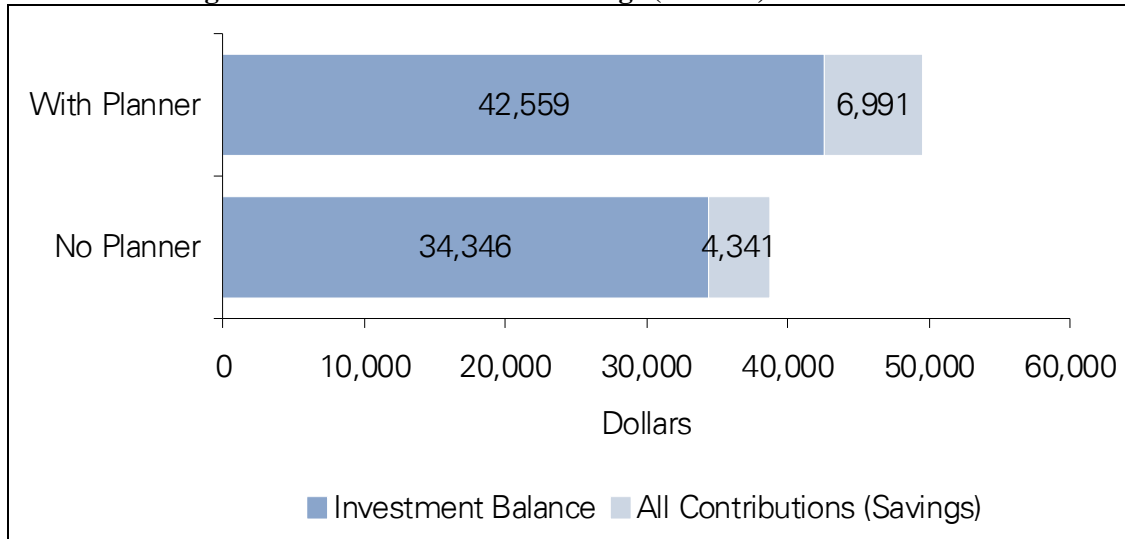
Regulations surrounding consumer protection requires that financial advisors/planners comply with ASIC Regulations. In addition to the regulations, most IFSA FANs provide additional consumer protection, with more than half of the respondents requiring advisors/planners to maintain a level of professional indemnity cover in excess of the minimum requirements.

Most IFSA FANs who responded to the survey track client satisfaction on a regular basis, enabling them to monitor consumer sentiment and enables them to identify and rectify potentially problematic situations. Client satisfaction is monitored both in house and by external providers, ensuring an unbiased estimate is received. Respondents who did not monitor client satisfaction were hoping to implement it soon, again showing the importance of client satisfaction.

As previously mentioned, greater provision of financial advice to Australians have economy-wide implications as the provision of quality financial advice has the potential to improve an individual's saving behaviour. KPMG Econtech estimated the economy-wide benefits of the additional saving generated from the provision of financial advice using data provided by one IFSA FAN. The data included over 840,000 individual accounts for the 2007/08 financial year.

The initial dataset was subjected to a battery of tests to test data integrity and suitability for further analysis. However, as with all analysis of this nature, drawbacks with the dataset remain. Notwithstanding these drawbacks, the data is able to provide indicative insights into the saving behaviour of those individuals with and without a financial planner.

Chart A: Average Investment Balance and Savings (2007/08)



Source: KPMG Econtech.

46 per cent of individuals in the data provided have a financial planner. For those individuals with a financial planner, they have an average total investment balance of \$42,559 compared to an average investment balance of \$34,346 for those who do not have a planner. The level of contributions (saving) in the 2007/08 financial year is on average \$6,991 for those with a planner and \$4,341 for those without. That is, in a year, those with a financial planner saved \$2,650 on average more than those without a planner. This initial descriptive analysis suggests that those with a financial planner save more and have greater investment balances than those who do not.

Following the initial descriptive statistical analysis, KPMG Econtech undertook regression analysis to control for other factors influencing savings behaviour such as wealth levels, age, employment, and salary. The regression analysis indicates that an individual with a financial planner is estimated to save an additional \$2,457 each year than those without financial advisors/planners. This additional saving is slightly lower than the average difference identified in the descriptive statistical analysis of \$2,650. The lower result from the regression analysis is expected as the regression analysis is controlling for other factors which influence an individual's saving behaviour¹.

Based on the regression analysis above, economy-wide modelling was undertaken to estimate the impact of more Australians receiving financial advice. Specifically, KPMG Econtech modelled the impact on the economy if an additional 5 per cent of Australians receive financial advice.

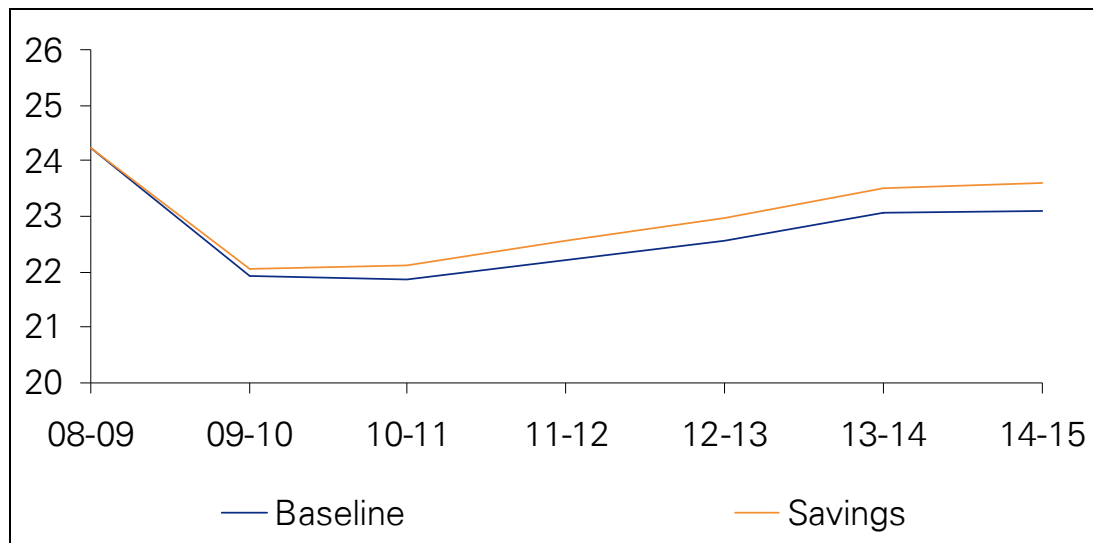
¹ This report is focused on the impact of financial advice on savings behaviour not valuing the advice received by financial advisors. If analysis was to be undertaken to value the financial advice received from financial advisors, the analysis would need to consider the rates of returns; associated risks; and the fees associated with the financial advice.

The economic impact of an increase in the prevalence of financial advice on the economy was estimated using KPMG Econtech’s dynamic model, MM2. MM2’s well-defined long-run economic properties and long horizon is particularly important in this project as the majority of benefits stemming from financial advice, namely increased saving and wealth accumulation, will accrue in the longer term.

Two scenarios were modelled using MM2, the **baseline scenario** which is based on the current prevalence of financial advice, and the **savings scenario**, which models a 5 per cent gain in the number of Australians with financial advisors/planners. It is important to note that the gain in the prevalence of financial advice modelled is not due to any particular policy, but rather through a behavioural change by individuals. The results from this behavioural change provide some guide to the likely economy-wide effects of a policy that successfully increases the number of Australians with financial advisors/planners, but the precise effects will depend on the exact nature of the policy.

Overall, Chart B shows that national saving is expected to be 0.50 per cent of GDP higher above baseline in 2014/15 as a result of the greater prevalence of financial advice by advisors/planners. It is this gain in national saving that has important economy-wide implications.

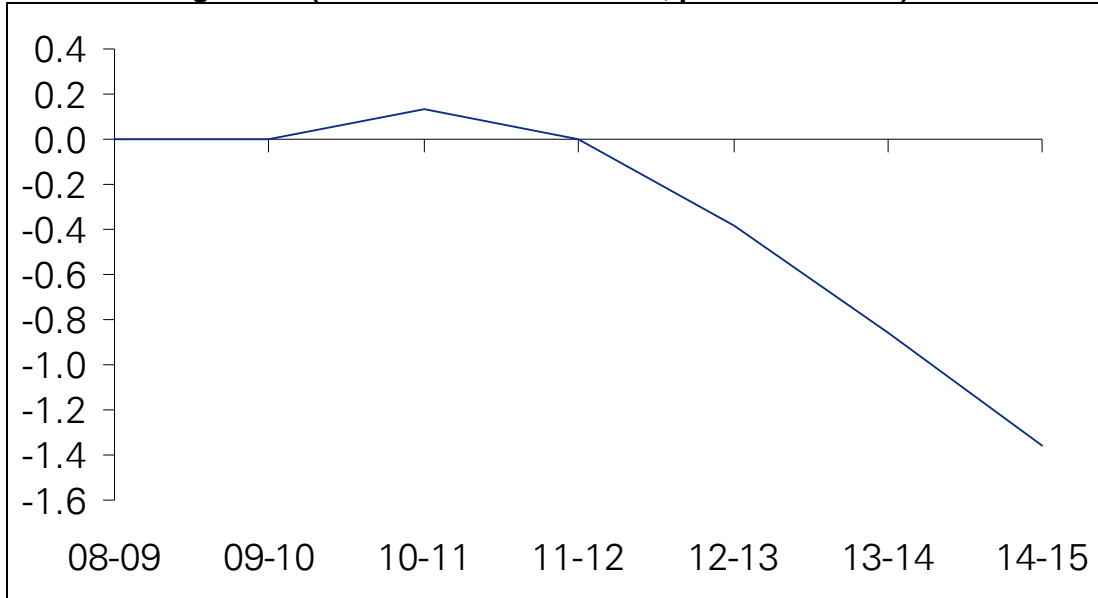
Chart B National Saving (per cent of GDP)



Source: KPMG Econtech MM2 simulation.

A gain in national saving increases the wealth of Australians. The higher wealth of Australians means there is less dependence on foreign financing of domestic capital. Chart C below shows the foreign debt deviation from baseline between 2007/08 and 2014/15. The increase in national saving as a result of more Australians receiving financial advice leads to a long-term reduction in foreign liabilities by 1.5 per cent of GDP than would otherwise have been the case. The lower reliance on foreign investment in this scenario could lower the risk premium for investment in Australia, so that gains in business capital are sustained in the longer term.

Chart C Foreign Debt (deviations from baseline, per cent of GDP)



Source: KPMG Econtech MM2 simulation.

During the transition phase towards this higher domestic asset position there are important economic consequences. The majority of the gain in national saving finances a reduction in the current account deficit, while the remainder finances a gain in investment. The ongoing reduction in the current account deficit leads to the mounting reduction in foreign liabilities discussed above. In addition, a prolonged period of higher investment leads to mounting gains in the capital stock. These gains in the capital stock support gains in GDP.

1 Introduction

The financial services industry is becoming increasingly complex and more regulated. The rise of Financial Advisory Networks (FAN) has been in response to a need for an entity to provide licensing, compliance systems, technology and training support for financial advisors/planners. Australia's FANs play an important role in providing financial advice to assist individuals and households (retail investors) accumulate, manage and protect their wealth.

The value of good quality financial advice is more evident in the current uncertain economic environment which has been created by the recent turmoil in the financial markets. Financial advisers seek to assist individuals in navigating the current economic climate and provide strategies for safeguarding wealth. More importantly, the support from a qualified financial planner may provide reassurance to individuals about their financial situation during these challenging financial times. There are also benefits that could be achieved in the broader economy from having more people receive professional financial advice. A tailored financial plan has the capacity to encourage additional savings in the form of investments and additional contributions to superannuation, while managing risks.

The Investment and Financial Services Association (IFSA) has a view that the provision of quality financial advice has the potential to provide consumers with a more appropriate wealth management strategy. A more appropriate strategy, as well as the financial discipline which often comes from having a financial planner, has the potential to lift the saving of an individual. Higher saving by individuals lead to gains in household saving and hence national saving; higher national saving has important economy-wide implications. Within this context, IFSA commissioned KPMG Econtech to investigate the impact of financial advice on individual savings behaviour and to undertake sophisticated economic modelling to estimate the economy wide implications of this boost in savings. The economy-wide modelling does not consider the other implications of financial advice to the economy, such as increased returns. To capture the wider implications, the rates of returns; associated risks; and the fees associated with the financial advice would need to be considered.

Importantly, the advice provided by financial advisors/planners varies in quality. In addition to estimating the economy-wide benefits of additional savings arising from FANs, KPMG Econtech will also analyse the role of FANs in providing quality financial advice.

The report is structured as follows:

- Section 2 firstly describes an IFSA FAN and outlines the needs and benefits of financial advice. Secondly, this section outlines the value and the meaning of quality financial advice. The section concludes with the results and analysis of a qualitative survey administered by KPMG Econtech of the services provided by IFSA FAN members.
- Section 3 outlines KPMG Econtech's approach to modelling the economy-wide benefits of the additional savings generated from the provision of financial advice to more Australians.
- Section 4 presents the key implications for the economy of an increase in the level of national savings as a result of more Australians receiving financial advice.
- Section 5 presents the main findings of this study.

2 Quality financial advice

The value and quality of the financial advice provided to consumers is linked to several driving factors. This section presents the results of our desktop research and outlines the results to the KPMG Econtech's qualitative survey analysis of IFSA FANs.

This section is structured as follows.

- Section 2.1 describes an IFSA FAN.
- Section 2.2 discusses the need and benefit of financial advice.
- Section 2.3 outlines the value of financial advice in qualitative terms.
- Section 2.4 presents the results of KPMG Econtech's qualitative survey of IFSA FANs.

2.1 What is an IFSA FAN?

A FAN is an entity that holds an Australian Financial Services (AFS) License, enabling authorised representatives of the network to provide financial advice to the public. An IFSA FAN is an entity that not only holds an AFS License, but also has a membership with IFSA. IFSA members include wholesale and retail funds management and life industry companies, a range of service suppliers supporting the industry, for example legal and accounting firms, research houses, asset consultants, and information technology providers².

FANs have been established to assist financial advisors/planners to meet their regulatory and professional obligations. FANs assist advisors/planners through the provision of process services such as IT systems, client management platforms, compliance processes and product research. These services are costly, making it uneconomical and impractical for most financial advisors/planners to provide these services individually. FANs have developed and have grown due to increased regulatory complexity and requirements imposed on the financial industry. The number of FANs has also increased due to the greater assistance needed by advisors/planners to meet their obligations and the growing number of products available to retail investors.

There are three variations of a FAN even though the basic structure is similar. FANs can be:

- one which is part of a larger institutional group and whose authorised representatives may be salaried or commission based;
- a franchise structure where authorised representatives operate their own businesses under the FAN's brand and subject to any restrictions imposed by the FAN; and
- an independent model where the FAN provides support for independent financial planning practices which operate under their own brand.³

² IFSA website *IFSA Members* available: www.ifsacom.au

³ IFSA, *Financial Advisory Networks*, p. 5.

It is estimated that the top 100 FANS have approximately 15,000 advisers. The largest FAN has more than 1400 advisers⁴.

2.2 The need and benefit of financial advice

Superannuation contributions made by the Australian population have increased by 97.5 per cent over the last 5 years⁵ as a result of government changes in superannuation regulations and taxation. Given the large contributions at stake, quality financial advice on product choices, investment strategies as well as the level of investment is now more important.

Research has shown that Australians can benefit from quality financial advice for several reasons⁶. Australians have one of the largest levels of personal investment in the world, although it still falls short of the investment needed for a comfortable retirement. It has been estimated that a couple retiring today require \$48,648 per annum to live a ‘comfortable’ lifestyle. In order to generate this level of annual income, a lump sum at retirement of approximately \$600,000 or more is required. However, the average super balance for those in the 60-64 age bracket is only \$202,600.⁷

Australians are rarely involved in managing their superannuation and even those approaching retirement feel unprepared as they do not think themselves as investors and lack the knowledge and confidence to engage in the process. Further research showed that 11 per cent of baby boomers have not given much thought to retirement and have made no preparations, 24 per cent have given some thought to it but made very little preparations and 44 per cent have made some but ‘not enough’ preparations.⁸ Most individuals surveyed felt they were simply saving for their future / retirement and that an investor needs to be someone who invested on a full time basis.⁹ Many Australians have said they are not confident and would like to learn more about investing and ensuring they have enough money for retirement.¹⁰

In addition, there are a number of risks facing those preparing for or entering retirement. Most of the risks are manifested via the sooner-than-expected depletion of retirement savings due to:

- living longer than expected;
- reduction in expected income due to poor market returns;
- loss of real purchasing power;
- poor outcomes due to inappropriate retirement planning;
- inability to supplement post-retirement income;
- failure of financial institutions; and

⁴ IFA Dealer Group Survey – Top 100, October 2009.

⁵ Ali A. Z., Derina, R. and Medlin C. J. 2008, Are investors better off with Independent Financial Advisors? – Perceptions of Australian Investors, *Journal of Financial Advice*, Vol. 1, Number 1, p. 34.

⁶ IFSA 2008, *Seven Fast Facts on Financial Advice (Including Three Case Studies)*, May.

⁷ Westpac-ASFA Retirement Standard research report, *Rice Warner’s Superannuation Market Projections*.

⁸ Mercer Wealth Solutions 2007, *Simple Super Research*, May.

⁹ ASIC Investor Research 2007, *Consultation Paper 89*, August.

¹⁰ Financial Literacy Foundation 2007, *Australian’s Understanding Money*, September.

- detrimental changes to government policy.¹¹

As the transition of funds into retirement or drawdown is forecast to reach \$1.2 trillion (or 39 per cent) of total superannuation assets over the next 15 years, it becomes increasingly important that people plan strategically for their retirement. Importantly, given the current economic environment, quality financial advice becomes essential in terms of safeguarding assets and investments.

2.3 The value of financial advice

Financial advice is obtained on a diverse range of services from investment and retirement planning, risk management and estate planning to specific product advice, superannuation and life insurance. As such, the value placed on financial advice is difficult to quantify. Given the recent turmoil in the global financial markets and the current economic environment, quality financial advice is increasingly valued in terms of safeguarding assets and investments. Research has shown that in such circumstances, financial advisors/planners could provide assistance in a range of areas including:

- market and investment foresight;
- financial knowledge regarding characteristics of various asset classes and sub-sectors within the classes;
- advice on tax and risk minimisation strategies, and
- investment vehicles to ensure the goals of the investor are met.¹²

Essentially, a financial planner can help bring control over an investor's potential irrational investment behaviour and assist in attempting to create a more optimised asset allocation. An internet-based survey taken in April 2008¹³ at the time of the financial downturn showed that:

- The education provided by financial advisors/planners has helped investors feel insulated from the downturn.
- Only one fifth of the investors rebalanced their portfolios, indicating that investors were comfortable with the advice they received from their financial advisors/planners and that their current investment strategy continues to be the correct one to pursue.
- Those investors who rebalanced their portfolios displayed a flight to quality with a significant shift to lower risk investments.

The survey results show that quality financial advice with regards to investment strategy and financial literacy, especially in times of market downturns and high volatility is valued by

¹¹ Matterson W., 2008, Risk in Retirement: Impact of the Market Downturn and Implications for Retirees and Product Providers, *Journal of Financial Advice*, Volume 1 No. 3, pp. 23-32.

¹² Ali A. Z 2008, Investor Reaction to Financial Turmoil – Can Financial Planners Help?, *Journal of Financial Advice*, Vol 1 No. 2, pp. 68-74.

¹³ Ali A. Z 2008, Investor Reaction to Financial Turmoil – Can Financial Planners Help?, *Journal of Financial Advice*, Vol 1 No. 2, pp. 68-74.

investors. Correct investment strategies and advice can help reassure investors and attempt to help them from making incorrect and sub-optimal rebalancing decisions.

In a 2006 survey by IFSA¹⁴, it was found that investors with financial advisors/planners felt more in control over their future, demonstrating a high level of confidence in all aspects of financial management. The results indicate that over 80 per cent of the sample of 378 investors with current advisors/planners felt that they have better financial preparation for retirement, greater knowledge and education of investment options, confidence in achieving lifestyle and financial goals, greater understanding of finance and confidence in making better investment decisions. Of investors with current advisors/planners, 60 per cent felt that they possess a reasonable to great understanding of investment compared to 46 per cent of investors without advisors/planners.

The reasons for satisfaction expressed by investors with current advisors/planners include:

- 24 per cent indicated they received helpful advice or good guidance in investments;
- 12 per cent indicated that they trust, have faith in their advisors/planners, respect their judgement or treat their advisors/planners like good friends;
- 11 per cent indicated they received clear and accurate advice that was easy to understand;
- 8 per cent indicated that recommendations from their advisors/planners resulted in good investments;
- 5 per cent indicated they were happy that they were kept fully informed and there was good communication between them and their advisors/planners; and
- 5 per cent indicated that they were happy because their portfolio/investments were doing well.

The 2008 IFSA survey¹⁵ showed an increase in satisfaction level, with 86 per cent of investors perceiving that having an advisor/planner results in better financial preparation for retirement. The percentage of investors with current advisors/planners who feel that they possess a reasonable to great understanding of investment increased to 63 per cent and decreased to 43 per cent for investors without advisors/planners.

In addition, the survey showed that regardless of whether investors have or do not currently have an advisor/planner, professional financial advice is valued strongly. Across all age groups, between 68-83 per cent of investors with advisors/planners and 29-59 per cent of investors with no advisors/planners agree that they value the help of a qualified financial advisor/planner in managing their money. Given the value placed on financial advice, presumably based on the benefits that investors believe they can reap from having quality financial advice, the survey shows a contrary real outcome in that only 40 per cent of active investors and 15 per cent of passive investors have a financial planner. The usage of advisors/planners is similar between the two surveys with current usage declining slightly from 42 per cent to 37 per cent¹⁶.

¹⁴ IFSA 2006, *Investor Sentiment 2006: Improving Financial Understanding & Creating Positive Messages for Investors*.

¹⁵ IFSA 2008, *Investors confidence: Improving financial understanding of Australians June 2008*.

¹⁶ IFSA 2008, *Investors confidence: Improving financial understanding of Australians June 2008* page 66

A range of other studies have also found that 83 per cent of Australians listed financial advisors/planners as their preferred source of financial information, followed by accountants at 81 per cent.¹⁷ Almost one third of Australians use the services of a financial planner with usage increasing with age from just 10 per cent of those aged 16-24 years, 27 per cent of those aged 25-34, 32 per cent of those aged 35-49 and 37 per cent of those aged 50+years.¹⁸

Investors with a financial planner also reported that they received more than just ‘product’ advice from their advisor/planner, with 80 per cent agreeing that their advisor/planner has given them greater:

- understanding of finances;
- knowledge and education about investment options;
- confidence that they’ll achieve their lifestyle and financial goals; and
- confidence that they are prepared for retirement.¹⁹

The research has shown that financial advice is valued for a diverse range of services from investment and retirement planning, risk management and estate planning to specific product advice, superannuation and life insurance. The next subsection outlines the quality of financial advice.

2.4 Quality provided by an IFSA FAN

The studies above analyse the value provided by financial advisors/planners generally. However, the advice provided by financial advisors/planners varies in quality. To analyse the role of FANs in providing quality financial advice, KPMG Econtech developed a survey to ascertain the measures taken by FANs to improve the quality of advice provided by their advisors/planners over and above those required by regulation. The survey covered quality indicators such as:

- training and development;
- compliance and risk management;
- product research and knowledge;
- consumer protection; and
- client satisfaction.

The survey was administered by KPMG Econtech to IFSA FAN members and nine responses were received. The following members provided responses to the survey: AXA; Suncorp; CFS; Securitor; AMP; ING (the four ING dealer groups responded separately). These IFSA FAN

¹⁷ Financial Literacy Foundation 2007, *Australian’s Understanding Money*, September.

¹⁸ Galaxy Research prepared for the FPA, May 2008.

¹⁹ IFSA/TNS Investor Sentiment Research November 2006.

members represent approximately 38 per cent of advisers in the top 100 Australian dealer groups. For statistical purposes, this is a large sample size from which robust inferences can be made.

The following sub-section outlines and analyses the responses received.

2.4.1 Survey Results

Table 4.1 provides a summary of the responses received from IFSA FAN members.

Table 2.1 Summary of KPMG Econtech Survey Results - Quality Aspects									
Respondent	1	2	3	4	5	6	7	8	9
Training and Development	-	✓	✓	✓	✓	✓	✓	✓	✓
Compliance and Risk Management	-	-	✓	✓	✓	✓	✓	✓	✓
Product Research and Knowledge*	✓	✓	✓	✓	✓	✓	✓	✓	✓
Consumer Protection	-	✓	-	-	✓	✓	✓	✓	✓
Client Satisfaction^	-	✓	✓	-	✓	✓	✓	✓	✓

Source: KPMG Econtech Survey

✓ Indicates respondent exceeds regulations - Indicates respondent member meets regulations

*Responses recorded refers to Question 3a ^ Refers to whether or not respondent monitors client satisfaction

As can be seen from the summary table, the majority of survey respondents reported that they currently exceed regulatory requirements in most categories. The key results are as follows:

- five out of nine respondents reported that they exceed current regulatory requirements in all five categories;
- product research and knowledge regulations were exceeded by all respondents;
- eight of nine respondents exceeded regulatory requirements for Training and Development;
- six of the nine respondents exceeded the regulatory requirements for consumer protection; and
- all respondents exceeded regulatory requirements in at least one of the five categories.

The following sections summarise the survey responses received from participation by each question.

Training and Development

The regulations surrounding the training and professional development of financial advisers include the Financial Services Training Package FNS04²⁰ – skills standards that apply to enterprises and individuals and to people working within the financial services industry and Australian Qualifications Framework ASIC Regulatory Guidelines (RG) 146. Eight of the nine respondents exceeded these training and development regulatory requirements. Survey

²⁰ <http://www.ibsa.org.au/content/financial/index.html>

respondents provided a range of additional training and development for their advisors/planners on top of those required by regulation. For most respondents, these additional training and development measures are a requirement of becoming a financial planner within their FAN. These additional training requirements range from generic industry topics through to specific product training. Common responses to specific training included technical training and compliance and licensing training. Some respondents also require advisors/planners to pass in-house accreditation to ensure that advisors/planners are competent with product advice and strategies before they can give advice to clients.

Compliance and Risk Management

Financial advisors/planners must comply with specific ASIC regulations and to ensure that representatives undertake Continuing Professional Development (CPD) to maintain and update their knowledge and skills as appropriate. Of the nine respondents, seven responded that they had to comply with additional requirements imposed on them at the FAN level. Many respondents require compliance and risk management pre- and post-appointment, and run ongoing checks for advisors/planners; compliance and risk checks are required throughout the year on a regular basis. One respondent indicated that authorisation under their licence is based on their advisors/planners achieving qualifications above the regulatory requirements. Specifically, additional qualifications are required to provide advice for certain areas including gearing, self-managed superannuation funds and reverse mortgages. Another respondent also has a due diligence program in place to vet new advisors/planners, counterparties and practices for prior compliance issues before they can join the organisation. Whilst some respondents require minimum pass marks in relation to their compliance review programs.

Product research and knowledge

The regulation surrounding the provision of advice for a particular financial product requires the adviser to first comply with ASIC RG 146 and to ensure that representatives undertake Continuing Professional Development. All survey respondents reported that they undertake additional research on products beyond what is required of them by regulation. Funds spent on product research and knowledge range between 3-10 per cent of their expenses, while some respondents spend between \$3-4 million. Respondents reported that research is conducted either internally or externally, or through a combination of the two. The most popular ways to distribute this information was through email, websites/internal intranet sites, reports, seminars and training days.

Consumer Protection

The regulations surrounding consumer protection requires that financial advisers meet their obligations by complying with ASIC RG 166 Licensing: Financial Requirements and RG 167. Of the respondents, six provided additional consumer protection, saying that the FANs maintain a level of professional indemnity cover in excess of the minimum requirements.

Client Satisfaction

Most respondents monitor client satisfaction. Seven of nine respondents currently monitored client satisfaction and other respondents said it was something that they were hoping to implement in the near future. Satisfaction was monitored through a variety of methods including surveys on investor satisfaction towards product range, fees, performance,

communications received, and also experience of contact with call centre where applicable. Client satisfaction was reported to have been monitored both in house and by external providers.

2.4.2 Survey analysis

It is clear that most IFSA FANs who responded to the KPMG Econtech survey not only comply with the regulatory requirements but also impose measures to improve the quality of advice over and above that required by regulation. This includes measures relating to quality indicators such as training and development, product research and knowledge, compliance and risk management and consumer protection. In addition, IFSA FANs who responded to the survey mostly track client satisfaction, enabling them to monitor their consumers and identify and potential problematic situations.

Financial services regulation requires licensees to provide adequate training for their representatives to ensure that they are competent to provide financial services. It is also a regulatory requirement to maintain that competence²¹. The Regulatory Guide 146 issued by the Australian Securities and Investment Commission (ASIC) sets out the training obligations required of the holder of an AFS License. The licensee is required to implement policies and procedures to ensure continued training for their representatives so as to maintain and update their knowledge and skills that are relevant to the provision of financial advice. ASIC however does not prescribe the level and detail of training required but the licensee is required to demonstrate that the training is appropriate for the type of advice and products provided by the representative.

In addition, the Financial Planning Association (FPA) imposes a minimum of 30-40 hours of Continuous Professional Development (CPD) training annually for membership renewal. CPD training can include conference attendance, external and internal training courses; and online training.

ASIC²² has also indicated that professional bodies such as FPA:

- have special responsibilities to protect the reputation of their profession by collectively developing 'best practice' standards beyond the minimum standards set out in the law and ASIC's policy and guidance; and
- should ensure that its standards must reflect appropriate disciplinary proceedings when individual advisors/planners fail to adhere to the standards set. FPA must have the ability, and the will, to discipline its members as and when necessary which extends to expelling those persons who continue to fail to meet FPA's expectations or whose individual activities render them inappropriate for membership.

This should be done so as to ensure quality standards that are associated with being a member of a professional body such as the FPA is maintained.

As well as the regulations imposed on financial advisors/planners, eight out of nine survey respondent IFSA FANs reported that they require their members to complete further training

²¹ Sect 912A(1) Corporations Act 2001

²² Australian Securities and Investments Commission (ASIC) 2006, *The Financial Advice Industry in Australia: The Regulator's Perspective*, An Address by Jeffrey Lucy AM Chairman of the ASIC.

and personal development activities. In addition, all respondents reported that they impose further requirements on product knowledge and research, ensuring the respondent advisors/planners have up to date knowledge and skills that are relevant to the provision of financial advice to their clients.

FANs assist their representatives to meet their regulatory and professional obligations. FANs are required to meet AFS licensee requirements. In addition, the FPA imposes professional and ethical standards as a condition of membership.

FANs operate compliance programs that ensure:

- financial advisors/planners adhere to licensee standards and legislation;
- complaints and disputes are managed appropriately²³;
- all reporting requirements are met; and
- the management and control of financial planner risk.²⁴

Consumers are further protected by the internal audits conducted by FANs ensure that advisors/planners understand their responsibilities and obligations as it includes a total review of the financial advisors/planners' business and education processes.

Despite the increase in the number and usage of advisors/planners, there has been no material increase in the number of complaints proceeding to EDRs such as the Financial Industry Complaints Service (FICS)²⁵. The FICS reports that 705 complaints progressed to investigation in the year 2008 compared to 713 complaints in 2006, 678 complaints in 2005 and 933 complaints in 2004²⁶.

The better compliance controls that are required of, and implemented by FANs, have the potential to have a positive beneficial effect to their consumers. The numbers of complaints that require resolution by external processes have by and large not increased over the years, which could be interpreted as higher level of satisfaction of the quality of advice received by consumers.

IFSA FANs are required to pass compliance and risk checks throughout the year on a regular basis. Authorisation under the licence are based on compliance with these additional levels of qualifications. Specifically additional qualifications are required to provide advice for certain areas including gearing, SMSF and reverse mortgages.

Regulations surrounding consumer protection requires that financial advisers complying with ASIC Regulations. However, more than half of the respondents maintain a level of professional indemnity cover in excess of the minimum requirements.

Most IFSA FANs who responded to the KPMG Econtech survey track client satisfaction on a regular basis, enabling them to monitor consumer sentiment and enables them to identify and

²³ Sect 912A(2) of the Corporations Act 2001 require that all AFS licensees are members of an ASIC approved External Disputes Resolution (EDR) scheme and maintain internal complaints resolution process. FANs are responsible for ensuring that complaints or disputes between planners and clients are resolved in a fair and quick manner, and where possible not to escalate it to the EDR scheme.

²⁴ IFSA, Financial Advisory Networks, p. 9.

²⁵ The FICS is now known as the Financial Ombudsman Service.

²⁶ <http://www.fics.asn.au/statistics08.asp>

rectify potentially problematic situations. Client satisfaction is monitored both in house and by external providers, ensuring an unbiased estimate is received. Respondents who did not monitor client satisfaction were hoping to implement it soon, again showing the importance of client satisfaction.

3 The value of quality financial advice

The previous section analysed the value proposition of IFSA FANs in providing quality financial advice. More generally, IFSA has a view that the provision of quality financial advice has the potential to provide consumers with a more appropriate wealth management strategy. That is, IFSA contends that good advice can lead to a reduction in risk through diversification and a better match between an individual's risk profile, based on factors such as age, risk tolerance, and their portfolio of assets. These factors, as well as the financial discipline which often comes from having a financial planner, have the potential to lift the saving of an individual. Higher saving by individuals lead to gains in household saving and hence national saving; higher national saving has important economy-wide implications.

It is within this context that KPMG Econtech undertook to measure the economy-wide benefits of the additional saving generated from the provision of financial advice to more Australians.

Before quantifying the economy-wide benefits of additional saving generated from financial advice, KPMG undertook statistical analysis and regression analysis to estimate the additional saving undertaken by individuals with a financial planner compared to individuals without a financial planner.

This report is focused on the impact of financial advice on savings behaviour not valuing the advice received by financial advisors/planners. If analysis was to be undertaken to value the financial advice received from financial advisors/planners, the analysis would need to consider the rates of returns; associated risks; and the fees associated with the financial advice.

To quantify the economy-wide benefits of higher national saving resulting from the greater provision of financial advice to Australians, KPMG Econtech's used our highly regarded macro-CGE model, MM2. MM2's well defined long run economic properties and long horizon is particularly important in this project as the majority of benefits stemming from increased saving, particularly from wealth accumulation, will accrue in the longer term.

This section is structured as follows.

- Section 3.1 outlines the broad approach to measure the value of financial advice.
- Section 3.2 details the sources of data employed for the quantitative part of this study.
- Section 3.3 outlines the descriptive statistical analysis that was employed for this study.
- Section 3.4 presents the economic theory underpinning the regression analysis.
- Section 3.5 details KPMG Econtech's approach to the economy-wide modelling.

3.1 Approach to Valuing Financial Advice

To measure the economy-wide benefits of the additional savings generated from the provision of financial advice to more Australians, KPMG Econtech undertook the following broad steps.

- **Descriptive Statistical analysis** – The initial dataset was subjected to a battery of tests to ensure data integrity and suitability for analysis. This initial analysis of the dataset provided

indicative insights into the saving behaviour of those individuals who have, and who do not have, a financial planner.

- **Regression analysis** – Following the initial descriptive statistical analysis, KPMG Econtech undertook regression analysis to control for other factors influencing saving behaviour such as wealth levels, age, employment, and salary.
- **Economy-wide benefits** – Lastly, economy-wide modelling was undertaken to estimate the impact of more Australians receiving financial advice. Specifically, KPMG Econtech modelled the impact on the economy if an additional 5 per cent of Australians receive financial advice.

The following sections provide more detail on each of the steps undertaken to quantify the contribution of financial advice to the individual and the national economy.

3.2 Data

To undertake this analysis, KPMG Econtech surveyed the IFSA FAN members for both qualitative and quantitative data. The complete survey is provided at Attachment A.

As noted earlier, the following IFSA FAN members provided responses to the qualitative component of the survey:

- AXA;
- Suncorp;
- Colonial First State (CFS);
- Secruitor;
- AMP; and
- ING (the four ING dealer groups responded separately).

Data from two large FANS also provided data responses for the quantitative component of the survey. However, due to the data requirements for this analysis, only data provided from one FAN was found to be suitable for this study.

The data included data on over 840,000 individual accounts for the 2007-08 financial year for customers with:

- funds under management (FUM) greater than \$1,000; and either
- a contribution has been received in the 2007/08 financial year; or
- a planner has phoned the organisation regarding the customer.

The data set covers a wide demographic and is considered to be suitable for this analysis. A complete list of the variables requested in the survey is provided at Attachment A. To protect the privacy of individual account holders, only results at the aggregate level are presented in this report. In addition, the data received by KPMG Econtech did not include any detail that allowed for individuals to be identified.

3.3 Descriptive Statistical analysis

As mentioned earlier, the initial dataset was subjected to a battery of tests to ensure data integrity and suitability for the analysis. However, as with all analysis of this nature, drawbacks with the dataset remain. For example, the data provided by the one IFSA FAN was for a particular year (2007/08) and could be subject to a particular point of the economic cycle which may impact on the savings behaviour of individuals. Notwithstanding these drawbacks, the data is able to provide indicative insights into the saving behaviour of those individuals with and without a financial planner.

As noted earlier, the data contained information on over 840,000 clients for the 2007/08 financial year. After removing the invalid observations, such as, clients closing their accounts during the year, only about 86 per cent of the original observations are valid for our analysis.

3.4 Regression analysis

Following the descriptive statistical analysis, the next step is to control for other factors influencing saving behaviour such as wealth levels, age, employment, and salary. To control for these other factors, KPMG Econtech developed an equation that relates an individual's saving to the factors that influence an individual's saving behaviour.

The basic model used to estimate the driving forces of an individual's saving decision may be expressed as:

Model A

$$Sav_i = a_0 + a_1PLA + a_2AGE + a_3SEMP + a_4OEMP + a_5MARCHIL + a_6BalanceALL3 + a_7FFS + a_8Salary$$

where:

- Sav = Captures the saving of each individual in the 2007-08 financial year.
- PLA = A dummy variable to indicate if an individual has a financial planner or not.
- AGE = Details the age of the individual.
- SEMP = A dummy variable to identify if the individual is self employed or not.
- OEMP = A dummy variable to identify if the individual is neither self employed or employed.
- MARCHIL = A dummy variable to identify if the individual is married with/out children or not.
- Balance(ALL3) = Captures the total balance for all types of accounts held by each individual at the beginning of the 2007/08 financial year.
- FFS = The dummy variable to indicate if the individual paid a fee for a specialist service in the 2007/08 financial year.

- Salary = This variable captures the salary level of the individual in the 2007/08 financial year.

The purpose of Model A is to model the factors that influence an individual's level of savings in the 2007/08 financial year. In particular, it shows how the level of savings depends on the individual's age, salary, marital status, and employment status. In addition, to control for the impact of an individual receiving financial advice, two dummy variables were included, PLA and FFS. The estimated coefficients of these dummy variables are able to provide an indication of the impact financial advice has on an individual's saving behaviour. In other words, the coefficient of the planner dummy variable (PLA) indicates the amount of additional saving that an individual who has a financial planner undertakes compared to an individual with the same characteristics who does not have a financial planner. The amount of additional saving identified in the regression analysis is used to estimate the impact on overall household saving if more Australians were to receive financial advice. The results for the regression analysis and the amount of additional savings of those who have financial advisors/planners over those who do not is, presented in Section 4.

In developing the structure of Model A, many different specifications were tested. These different model specifications were compared to test the robustness of each approach given the straightforward intention of the model. At the same time, diagnostic tests, such as those examining the goodness-of-fit and the error properties of the models, were also undertaken to determine the most appropriate model.

3.5 Economy-wide Modelling

As mentioned earlier, to quantify the economy-wide benefits of more Australians receiving financial advice, KPMG Econtech modelled the impact of an additional 5 per cent of Australian receiving financial advice. The earlier KPMG Econtech analysis was able to quantify the additional savings that those individuals with financial advice have above those who do not receive financial advice. This additional amount of savings was used as a basis to simulate the economy-wide impacts of a 5 per cent increase in Australians receiving financial advice. The simulation of a 5 per cent increase in Australians receiving financial advice was undertaken to demonstrate the economy-wide implications of a relatively small increase in financial advice prevalence.

The economic impact of changes to Australia's national saving on the economy was estimated using KPMG Econtech's MM2. MM2 is a fully integrated macro-industry econometric model which can be used to fully capture both the direct and indirect impacts of increases in the level of national saving on the Australian economy over time. MM2 is designed for macroeconomic forecasting and policy analysis and it also contains broad industry detail.

3.5.1 Modelling Approach

The regression analysis indicates that those individuals who have a financial planner save more compared to individuals with similar characteristics who do not have a financial planner. Thus, the economy-wide impact of a greater prevalence of financial advice is modelled as a reduction in household consumption compared with the baseline scenario. The reduction in consumption

reflects those additional individuals with advisors/planners choosing defer consumption and saving more. The magnitude of the reduction in consumption that is modelled is determined using the results of the regression analysis.

The results from this behavioural change provide some guide to the likely economy-wide effects of a policy that successfully lifts the prevalence of financial advice, but the precise effects will depend on the precise nature of the policy. This will be an important point when interpreting the results of the scenarios.

3.5.2 Scenarios

One baseline and one Increased National Savings scenario are modelled for this report.

- The **baseline scenario** is based on the current prevalence of financial advice . The baseline forecasts provide a picture of the current and future demographic and economic conditions.
- The **savings scenario** has been modelled to estimate the effect of a 5 per cent increase in the number of individuals with a financial planner.

MM2 has the following important features that make it well suited for the analysis in this report.

- MM2 is a macro Computable General Equilibrium (CGE) model that fully recognises the interrelationships between the supply and demand sides of the economy. The model recognises that the demand side is important in influencing economic activity in the short term, but at the same time it converges to the long run of a CGE model.
- The MM2 has been developed to be consistent with Australian data. Equation dynamics were developed by applying the general to specific approach in an error correction framework. The equations were subjected to a battery of diagnostic testing.
- For consistency with economic theory, the MM2 has long-run properties of steady state growth, profit maximisation, external balance, fiscal balance, and equilibrium rates of inflation and unemployment. The theory-related dynamic properties of the MM2 include rational expectations in financial markets, and a hierarchical adjustment process featuring a Keynesian short run, a classical medium run, and a neoclassical long run.
- The supply side of the MM2 is just as important as its demand side. Thus, Gross Domestic Product (GDP) on the production side is modelled in some detail, as well as the expenditure side. In fact, the modelling of production complements, and fully integrates, with the modelling of expenditure. GDP on the production side is disaggregated into the 18 broad Australian and New Zealand Standard Industry Classifications (ANZSIC) industries, linked together through an input-output table.

MM2 is based on the common view that while demand shocks may affect economic activity in the short term, in the long term economic activity is supply driven. Specifically, in long-run equilibrium:

- the unemployment rate converges to a NAIRU (non-accelerating inflation rate of unemployment);
- economic growth is steady and balanced; and
- the exchange rate appreciates/depreciates at a steady rate, allowing domestic inflation to be permanently below/above foreign inflation.

More information about MM2 is presented in Appendix B

4 The economic contribution of financial advisors/planners

Section 3 outlined the methodology underpinning the analysis into valuing financial advice to individuals and the national economy. This section discusses the results for the descriptive statistical analysis, regression analysis and the economy-wide implications of an increase in the number of individuals receiving advice from financial advisors/planners.

This section is structured as follows.

- Section 4.1 outlines the key findings of the descriptive analysis.
- Section 4.2 details the pertinent results of the regression analysis.
- Section 4.3 presents the results of the economy-wide modelling of an increase prevalence of financial advice.

4.1 Descriptive Statistics

As discussed in Section 3, to estimate the economy-wide benefits of the additional savings generated from the provision of financial advice to more Australians, KPMG Econtech began with a descriptive statistical analysis. This analysis was to check the data integrity and check the suitability of the data for regression analysis. In addition, this initial analysis included partitioning the data set to consider the descriptive statistics for broad groups. Most importantly, this analysis provided insights into the saving behaviour of those individuals with and without financial advisors/planners. Table 4.1 outlines the two key variables from the dataset, the total investment balance and the total contributions to their investment, superannuation and other accounts (saving) for those who have and do not have a financial planner for the 2007/08 financial year.

46 per cent of individuals in the data provided have a financial planner. Those with a financial planner have an average total investment balance of \$42,559 compared to an average investment balance of \$34,346 for those who do not have a planner. This difference is over \$8,000.

The level of contributions (saving) in the 2007/08 financial year is on average \$6,991 for those with a planner and \$4,341 for those with out. That is, those with a financial planner save on average \$2,650 more in a year than those without a planner. This initial descriptive analysis suggests that those with a financial planner have greater investment balances and save more than those who do not.

The following section outlines the results of the regression analysis. The regression analysis controls for the other factors that can influence the saving behaviour of individuals.

Table 4.1: Selected Descriptive Statistics

	With Planner		No Planner	
	Investment Balance	All Contributions (Saving)	Investment Balance	All Contributions (Saving)
Obs	332,513	332,513	394,310	394,310
Mean	42,559	6,991	34,346	4,341
Median	16,539	0	14,809	90
1st quantile	5,890	0	5,718	0
3rd quantile	42,453	2,015	36,022	1,440
max	27,335,124	7,163,309	11,471,893	10,048,926
min	0	-88,968	0	-37,829
Stdev	105,311	59,671	79,503	46,232
variance	11,090,305,422	3,560,676,349	6,320,670,702	2,137,411,806
skewness	60	31	26	59
kurtosis	13,713	1,714	2,252	7,829

Source: KPMG Econtech calculations.

Note: Skewness is a measure of asymmetry of the distribution of the series. The skewness of a symmetric distribution, such as the normal distribution, is zero. Positive skewness means that the distribution has a long right tail and negative skewness implies that the distribution has a long left tail.

Kurtosis measures the peakedness or flatness of the distribution of the series. The kurtosis of the normal distribution is 3. If the kurtosis exceeds 3, the distribution is peaked relative to the normal. If the kurtosis is less than 3, the distribution is flat relative to the normal.

4.2 Regression Analysis

Following the initial descriptive statistic analysis, KPMG Econtech undertook regression analysis to control for other factors influencing saving behaviour such as wealth levels, age, employment, and salary. Detailed regression results are presented at Appendix C.

All of the variables except for salary are found to be significant and all of the variables have the expected signs. According to the regression analysis, the coefficient of the PLA dummy variable is \$2,457. This means that if an individual has a financial planner, they are estimated to have saved an additional \$2,457 compared to other individuals with the same characteristics but who do not have a financial planner. This additional saving is slightly lower than the average difference identified in the descriptive statistic analysis of \$2,650. The lower amount estimated for those with a financial adviser in the regression analysis was expected, as the regression analysis is controlling for other factors which influence saving behaviour.

The results from this regression analysis play an important role in the economy-wide modelling component of this report. As mentioned previously, the economy-wide impact of financial advice is modelled as a gain in household saving. The magnitude of the reduction in consumption (gain in household saving) that is modelled is determined using these results and the assumption that an additional 5 per cent of Australians receive financial advice.

4.3 Economy-wide Modelling

4.3.1 Baseline

As explained in Section 3, MM2 is used in this report to generate two scenarios. These are a **baseline scenario** and the **saving scenario**.

The baseline scenario is based on existing policy arrangements and the current prevalence of financial advice. The baseline forecast provides a picture of the current and future economic conditions of the Australian economy if there is no increase in the number of individuals with financial advisors/planners. The baseline scenario serves as a point of reference for the saving

scenario — the results of the saving scenario are expressed as deviations from the **baseline scenario**.

The results of the saving scenario are not forecasts of the future. The saving scenario estimates the impact of a different scenario, in particular the impact of a greater prevalence of financial advisors/planners. The magnitude of the results, expressed as deviations from “baseline”, reflect the size of the policy shock and the coefficients of the model’s equations.

To explain the findings of the baseline scenario, this section begins with an explanation of the state of the economy at the aggregate macro level and this is followed by an analysis of the economy at the industry level.

4.3.2 State of the Economy

To gain a firm understanding of the impact of a greater prevalence of financial advisors/planners, it is important to understand the current economic climate.

With the worst of the news from the US housing market over, lending conditions have begun to normalise; frosty credit markets have been thawing throughout 2009 and risk premiums are moving back towards their longer-term averages. Following repeated downgrades for 2009 global GDP growth, the IMF most recently revised its forecasts upwards, from -1.4 per cent to a slightly less pessimistic -1.1 per cent.

Australia appears to have escaped the worst of the fallout from the credit crisis and will almost certainly avoid a technical recession. The economy defied all predictions to record positive GDP growth in the March and June quarters of 2009. Stronger than expected consumer spending, and solid employment data, along with signs of recovery in China has led us to revise up our growth forecast.

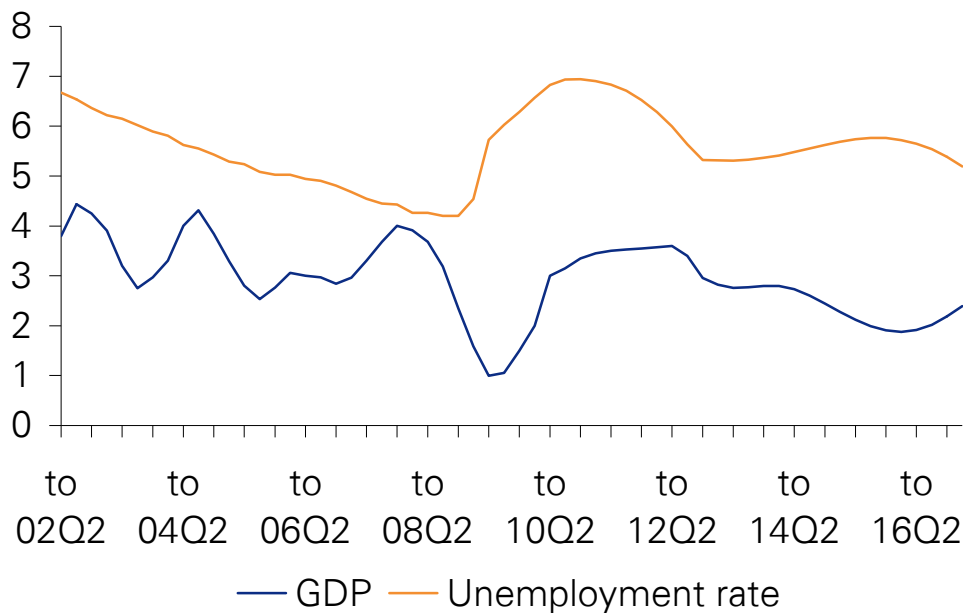
Economic growth is forecast to recover slowly over the remainder of the current financial year. GDP growth for 2009/10 is forecast to come in at around 3 per cent. This rate of growth is around the normal rate. Weakness during the first half of this financial year will be compensated for by a recovery in the second half. The business investment outlook remains bleak, with investment expected to fall by around 8.7 per cent in 2009/10 before recovering slowly. Although credit markets globally have begun to normalise, tight lending conditions will continue to affect borrowings and therefore investment levels for some time to come. In particular, the pipeline of non-residential construction has dried up. Developers are still finding it difficult to borrow due to the ongoing impact of the global financial crisis and declining asset values are pushing up gearing ratios. As such, investment is expected to fall from the high levels seen during 2007/08 and 2008/09 over the next two years. Consumer spending will also remain weak as households rein in spending in response to rising unemployment and weak income growth.

There are several reasons to expect the recovery phase to begin in early 2010. The government has geared its fiscal policy towards fighting the effects of the economic slowdown, announcing large spending packages to try and limit the increase in unemployment. The 2009/10 Budget contained a further \$22 billion in infrastructure spending.

The headline unemployment rate was 5.7 per cent at its latest reading, recording a surprise fall in the month of September 2009. Despite the monthly decrease, the jobless rate is expected to

continue rising to peak at around 7 per cent in mid-2010. Employment growth is expected to be very weak, at just 0.1 per cent in the 2009/10 financial year. This weakness in the labour market has reined in wage growth and this will improve profitability and thus contribute to Australia’s recovery. These movements in economic growth and the unemployment rate can be seen in Chart 4.1.

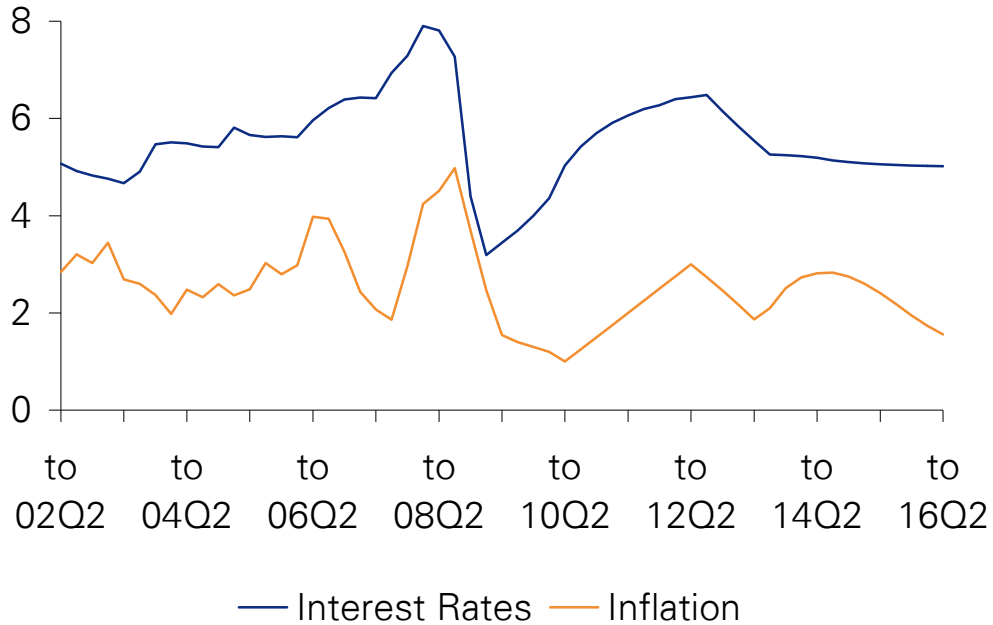
Chart 4.1 Economic Growth (GDP) and Unemployment Rate (rolling years, per cent)



Source: KPMG Econtech MM2.

The global economic slowdown drew dramatic monetary and fiscal policy responses from governments and central banks all over the world. To help Australia ride out the period of weaker economic growth, RBA cut rates to all-time lows. With inflation well under control and the Australian economy now showing signs of recovery, the RBA has publicly stated that it will gradually increase interest rates from their current “emergency levels”. There has already been one interest rate rise and many market analysts believe that there will be another rate increase before the end of 2009. This would take official interest rates to 3.5 per cent. Although the RBA has now begun to increase the official interest rate, it still remains low by historical standards. Low interest rates will help to stimulate consumer demand and assist in Australia’s ongoing economic recovery. Low interest rates will also support a recovery in dwelling investment once employment stabilises and credit conditions normalise. The profile of inflation and interest rates is shown in Chart 4.2 below.

Chart 4.2 Inflation and Interest Rates (per cent)

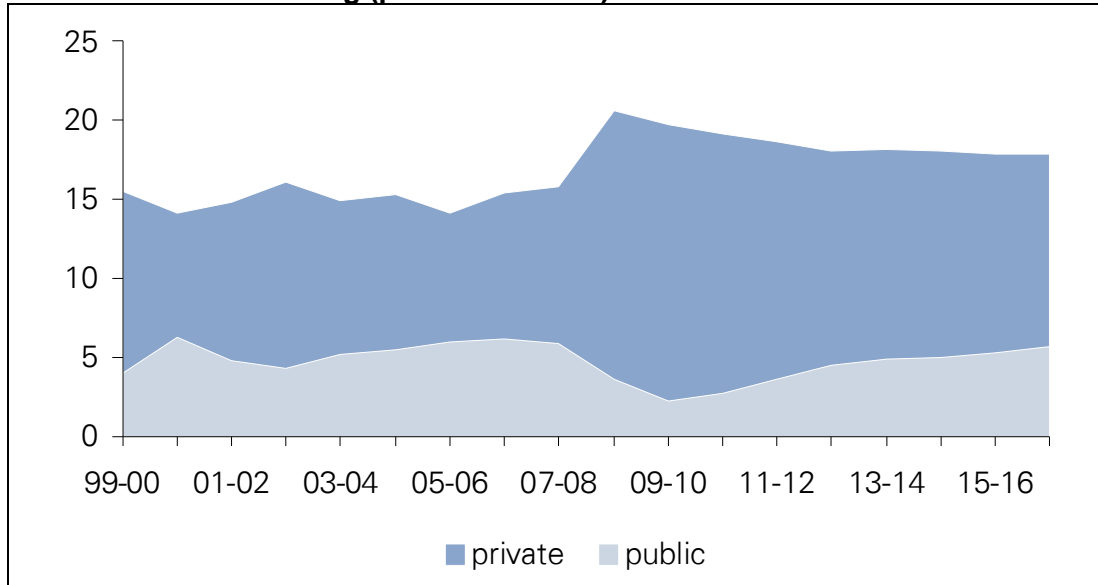


Source: KPMG Econtech MM2.

Saving is one avenue through which individuals smooth out their consumption profile. During times of slow economic growth and lower income, individuals draw down their saving in order to dampen the impact of lower income on consumption. In contrast, during more prosperous economic times, individuals earn higher incomes and put aside more of their income as saving. For example, the forecast slowdown in economic growth over the short term is expected to cause national saving to fall temporarily in 2010/11 from 2009/10 levels. However, this will be followed by a recovery period of stable growth in national saving levels.

Overall, given the forecast economic conditions under the baseline scenario, national saving is expected to increase from 22 per cent of GDP in 2009/10 to 23 per cent by 2014/15. The split between private saving and public saving is quite stable throughout the forecast period, with private saving making up approximately 80 per cent of national saving. The movement of national saving throughout the forecast period can be seen in Chart 4.3 below.

Chart 4.3 National Saving (per cent of GDP)



Source: KPMG Econtech MM2.

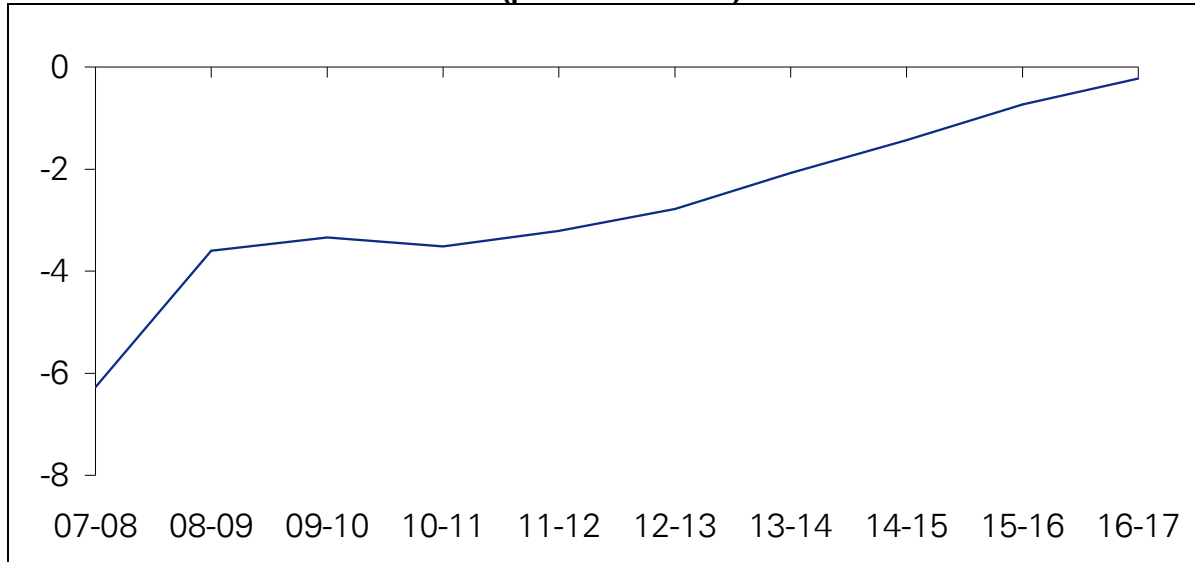
An increase in national saving will improve Australia’s current account balance. The current account balance is comprised of the goods and services balance, the net income balance and the transfer balance²⁷. Historically, the net income deficit is the largest component of Australia’s current account deficit.

The capital and financial account balance is the sum of net capital transfers and net acquisition of both financial and non-financial assets. Due to the double entry accounting framework underlying the construction of the balance of payments, the current account balance can also be thought of as the negative of our capital and financial account balance. A current account deficit corresponds to a capital account surplus and a current account surplus corresponds to a capital account deficit.

Another way to interpret the current account deficit is as the shortfall between domestic saving and investment which must be met by funds from abroad flowing into Australia. The current account deficit is funded by borrowing from overseas. Foreign residents receive Australian assets in return for funding Australian domestic investment. Hence, when Australia’s capital account is in surplus, the value of Australian assets held by foreigners is greater than the value of foreign assets held by Australians. An increase in saving will necessarily improve Australia’s current account balance as the gap between domestic saving and investment tightens.

²⁷ The goods and services balance is defined as the difference in the value of exports relative to the value of imports. The net income balance is defined as income earned by Australian residents on their overseas investments, such as dividends and interest less the income earned by overseas residents on their Australian investment. The transfer balance is a relatively small component, comprised of the counterparts to one sided transactions such as foreign aid

Chart 4.4 Current Account Balance (per cent of GDP)



Source: KPMG Econtech MM2.

Chart 4.4 above shows KPMG Econtech’s forecast of the current account balance. In 2008/09 the current account deficit is estimated to shrink to 2.3 per cent of GDP from 6.2 per cent of GDP in 2007/08. The current account deficit is expected to continue to improve from 2009/10 onwards due to strong growth in exports driven by Mining and Agriculture. At the same time, the slowdown in consumption growth will moderate the growth in imports

4.3.3 State of the Industries

Chart 4.5 below depicts the average annual growth in gross product of 16²⁸ ANZSIC²⁹ industries between 2007/08 and 2015/16. The industries experiencing the strongest growth are listed below.

- Agriculture
- Mining
- Transport

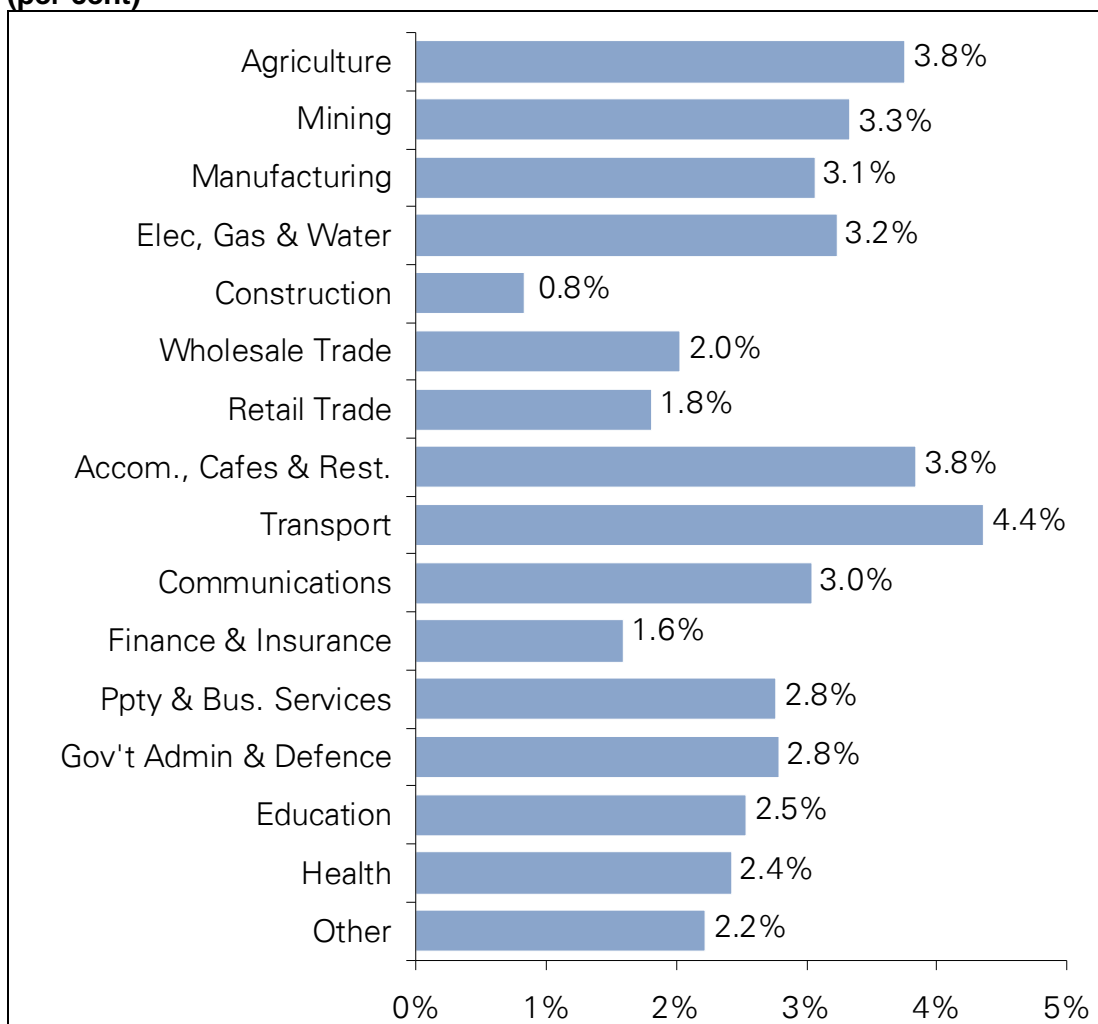
Output in the Agriculture industry is forecast to grow at 3.8 per cent this financial year, before reverting to more stable growth rates for the remainder of the forecast period. This industry should outperform the wider economy, as the depreciation of the AUD encourages export growth in key markets. Favourable climactic conditions are also expected to promote high crop yields, meaning that an expansion in the output of grains, sugar and cotton will be the main driver of growth for this industry. Alternatively, growth in livestock output (beef, sheep, wool and dairy) will remain subdued due to increased competition in export markets and the impact of recent slaughterings on herd levels. The Transport industry are benefiting from Government

²⁸ The smaller Personal and Other industry and Culture and Recreation Services industry are combined in one “Other” industry.

²⁹ Australian and New Zealand Standard Industry Classification.

initiatives focussing on improving infrastructure bottlenecks. High levels of investment in the mining industry were held up throughout 2008/09, due to the existing pipeline of Mining projects. Looking forward, investment in Mining is expected to begin declining in 2009/10 from its very high levels. Given that commodity prices are unlikely to return to the high levels that were seen over the last few years, further investment in the Mining industry will be less attractive over the medium term. Annual average growth in output for the Mining industry is forecast to average 3.3 per cent per annum between 2007/08 and 2015/16.

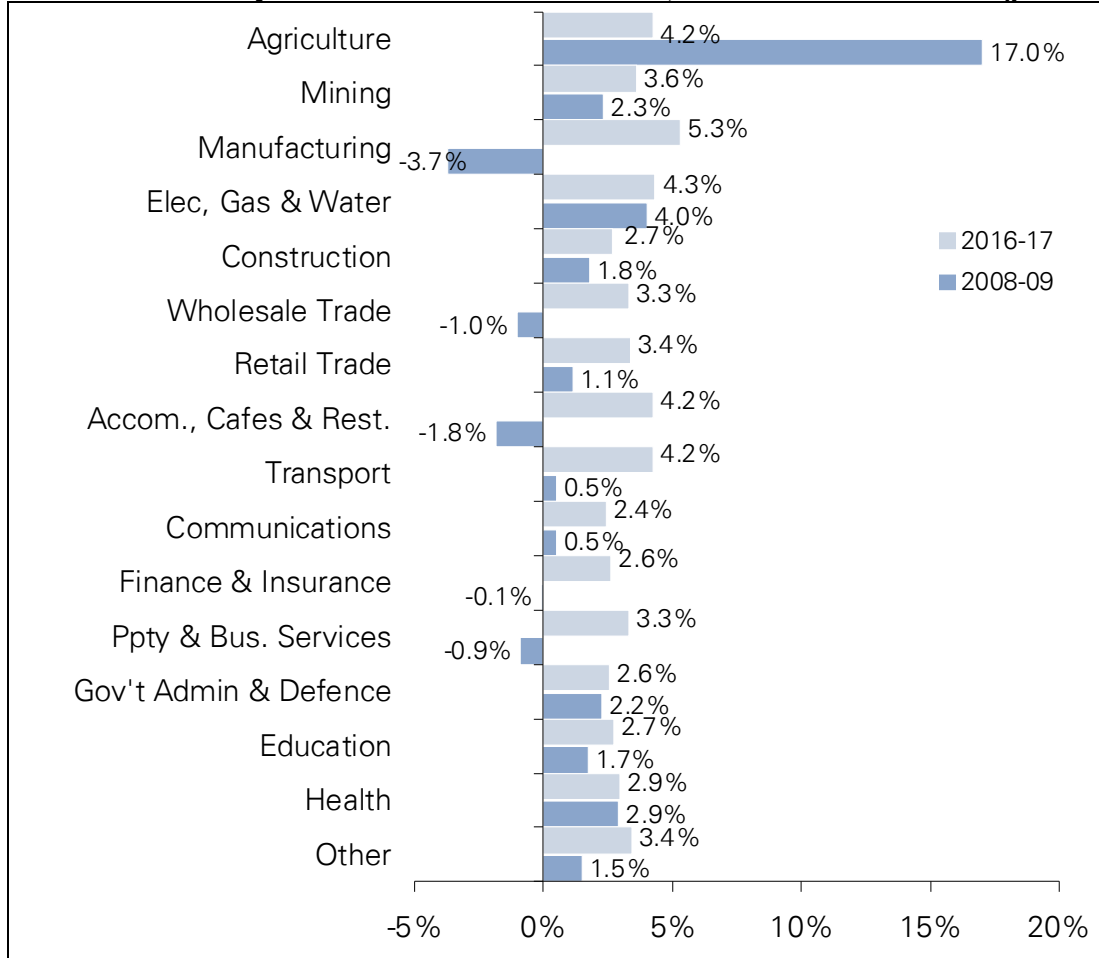
Chart 4.5 Gross Product, Average Annual Growth between 2007/08 and 2015/16 (per cent)



Source: KPMG Econtech MM2.

Note: 'Other' includes the Culture and Recreation Services industry and the Personal and Other Services industry.

Chart 4.6 Industry Share of Total Investment, 2007/08 and 2015/16 (per cent)



Source: KPMG Econtech MM2.

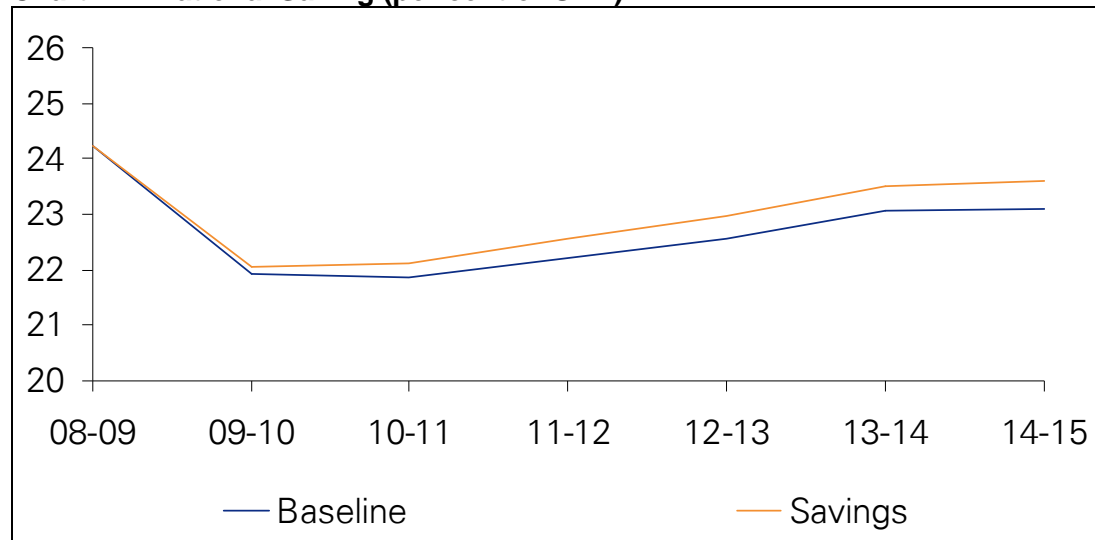
A similar pattern to gross product is seen across industry investment flows as shown in Chart 4.6. During the forecast period most industries roughly maintain their share of total investment. However, investment in the Agriculture industry as a share of total investment falls from 17.0 per cent in 2008/09 to 4.2 per cent in 2016/17. The Transport industry is also expected to increase their share of total investment by 2015/16. As mentioned previously, this is largely due to high levels of government investment in this industry.

The following section discusses the impact of a greater prevalence of financial advisors/planners on the economy.

4.3.4 Economic Implications of a greater prevalence of financial advisors/planners

As discussed earlier, the savings scenario looks at the impact on the economy if an additional 5 per cent of Australians received financial advice and as a result, increased their rate of saving.

Chart 4.7: National Saving (per cent of GDP)



Source: KPMG Econtech MM2 simulation

Chart 4.7 above depicts the profile of national saving between 2007/08 through to 2014/15. By 2014/15 there is a 0.50 per cent of GDP gain in national saving as a result of more Australians receiving financial advice than would otherwise be the case.

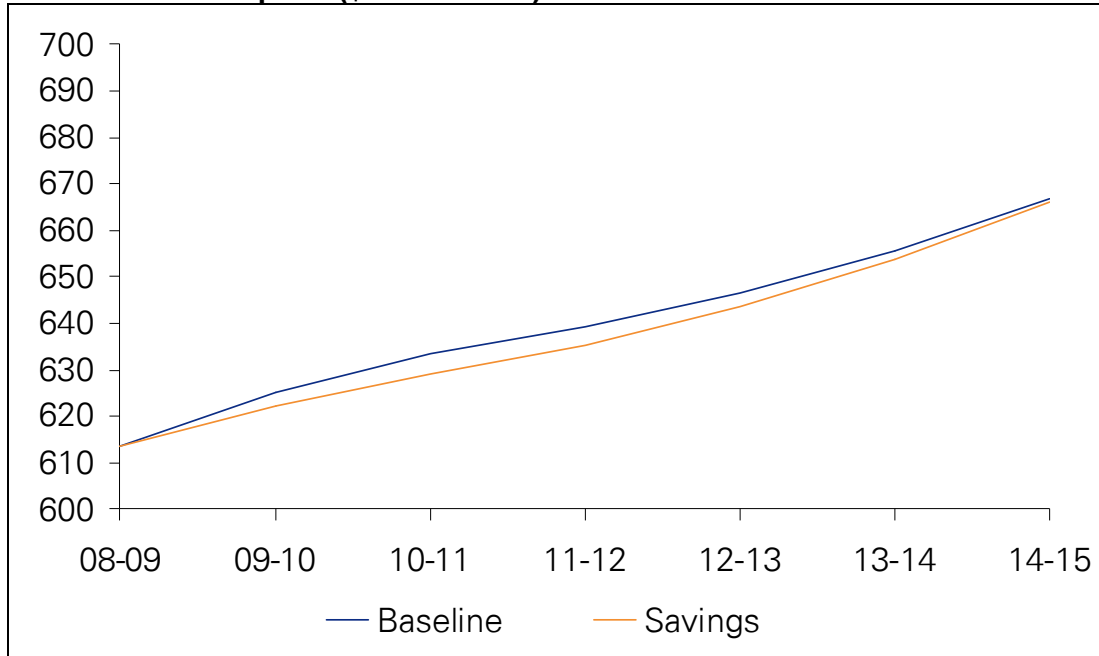
Consumption

The results of our modelling show that the main economic argument for lifting the number of Australians with financial advisors/planners and hence increasing national saving continues to be from an intergenerational equity perspective. An increase in the current level of national saving allows for higher living standards during retirement, where living standards are measured from consumption levels. Saving is a way for individuals to defer consumption from the present to the future.

The key driver of the pick-up in consumption is an increase in wealth. Saving can also be thought of as the change in the wealth level or the change in assets held by individuals less the change in liabilities. As saving rates increase, so does the stock of wealth. This increase in the stock of wealth means that individuals are able to finance a higher level of consumption than before.

This shifting of consumption from the present into the future is seen in the modelling results. Chart 4.8 below shows the path of consumption under the baseline scenario and the saving scenario. Consumption, while still growing, is clearly below the baseline trajectory as households accumulate additional wealth. In the long term this additional wealth allows them to then finance a higher level of consumption. Individuals are then able to enjoy a higher standard of living in their retirement without placing an undue burden on later generations.

Chart 4.8 Consumption (\$06/07 billion)

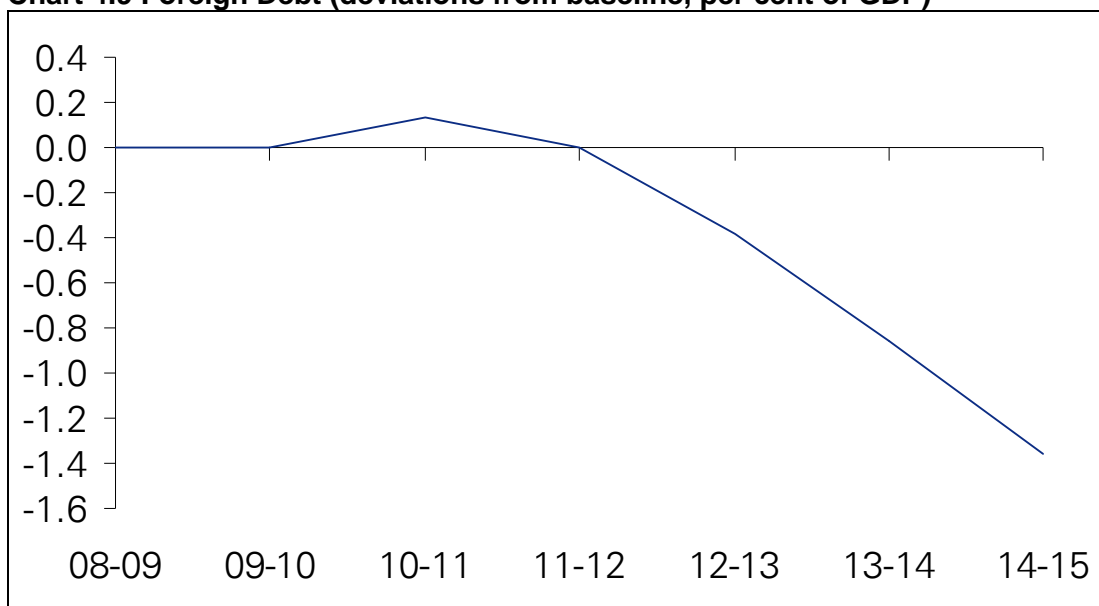


Source: KPMG Econtech MM2 simulation.

Foreign Debt

The higher wealth of Australians, as a result of the increase in national saving rates, leads to less dependence on foreign financing of domestic capital. In the long run foreign liabilities are approximately 1.5 per cent of GDP lower under the saving scenario than in the baseline scenario. Chart 4.9 below shows the foreign debt deviation from baseline between 2007/08 and 2014/15.

Chart 4.9 Foreign Debt (deviations from baseline, per cent of GDP)



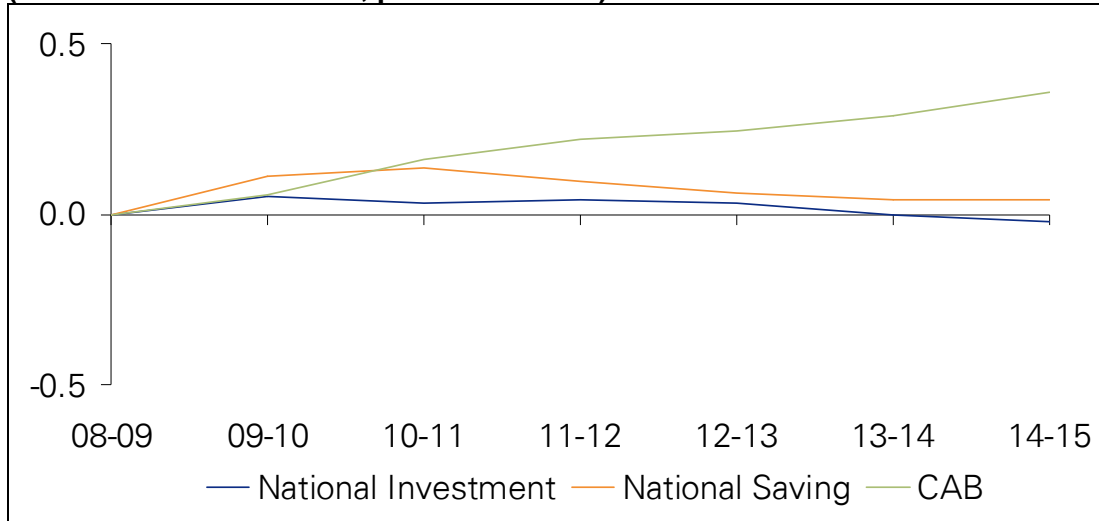
Source: KPMG Econtech MM2 simulation.

Transition Phase

During the transition phase towards this higher domestic asset position there are important economic consequences. Under the Increased National Savings scenario, the gain in national saving relative to the baseline scenario averages around 0.1 per cent of GDP in the medium term.

An increase in national saving closes the gap between domestic saving and investment and this leads to an improvement in the current account balance. A higher level of domestic saving allows for a higher level of Australian investment to be financed domestically, rather than from overseas. The ongoing reduction in the current account deficit leads to the mounting reduction in foreign liabilities discussed above.

**Chart 4.10 Saving, Investment and Current Account Balance
 (deviations from baseline, per cent of GDP)**



Source: KPMG Econtech MM2 simulation.

The deterioration of Australia's current account deficit largely reflects the strong investment opportunities in Australia. Thus, Australia's dependence on overseas borrowing is not a pressing issue during times when financial markets are stable and there is positive sentiment towards Australian investments. Historically, the risk premium levied on Australia's borrowing costs has been quite modest. Recently however, the global financial markets have been destabilised by the sub-prime mortgage collapse in the United States. Running large current account deficits leads to escalating foreign debt levels. This increases the sensitivity of the Australian economy to international economic shocks which have the potential to affect foreign investor sentiment towards investing in Australia, such as the sub-prime crisis. A higher level of national saving would help insulate Australia against adverse global financial shocks by reducing Australia's level of foreign debt.

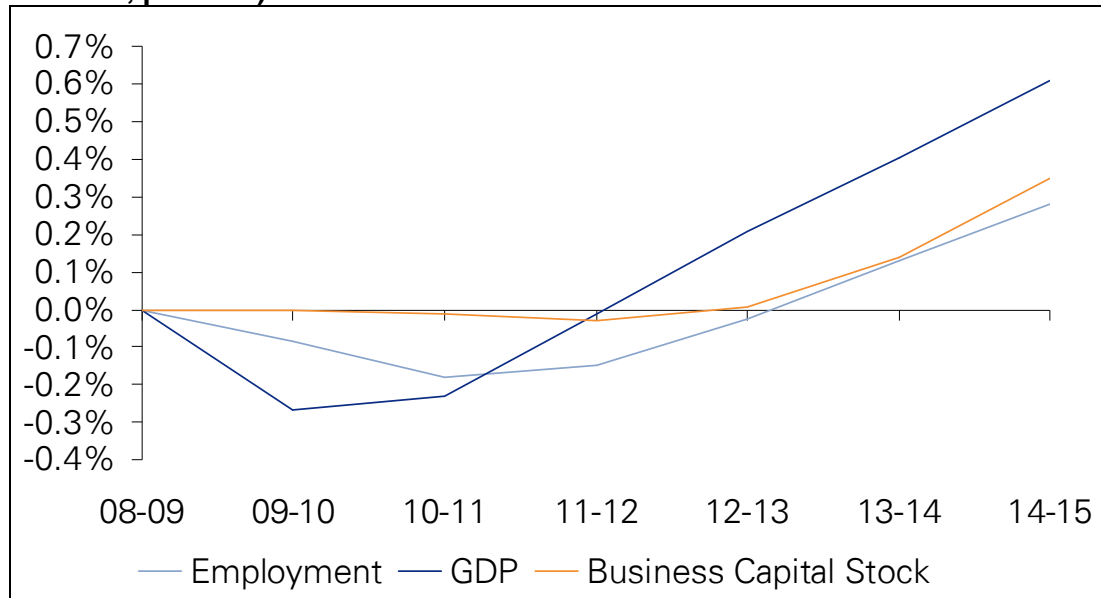
The gain in national investment under the saving scenario extends to increases in capital stocks over time. These gains in capital stocks across the industries support gains in GDP. The increase in the capital stock expands the economy's productive capacity over the medium term. However, in the first few years of the saving scenario, GDP is below baseline as individuals moderate their consumption growth. The increase in output acts as a stimulus on employment, increasing employment above baseline. The pattern in employment generally follows the pattern in output with a lag. This is shown in Chart 4.11 below.

Under the saving scenario, GDP is 0.6 per cent above baseline in 2014/15, supported by gains in business capital and employment of 0.4 per cent and 0.1 per cent respectively. The gains in GDP are not maintained over the longer term. Over time GDP returns to baseline levels in dampened oscillations. This is because the gain in capital stock, which is driving the gain in GDP, is not maintained over the longer term. In the long term, with full employment, the level of capital is determined by the required rate of return on investment and the depreciation rate of the capital stock. The assumption that Australia is a small open economy with no impediments to international capital flow means that the required rate of return is set exogenously, outside of Australia's control, on a global basis. Since there is also no reason to believe that the

depreciation rate has altered, an increase in national saving does not change the economy's long run level of capital.

The assumption that Australia is not able to change the required rate of return applied to domestic investment reflects the conservative nature of the modelling. As previously mentioned, an increase in national saving reduces the level of Australia's foreign liabilities. This could potentially lower the risk premium applied by international investors to investment in Australia. It is possible that by lowering the risk premium, and hence the required rate of return, the gains in business capital are sustained in the longer term. Under this assumption the increase in productive capacity stimulated by the increase in national saving is maintained over the long term.

Chart 4.11 GDP, Employment and Business Capital Stock (deviations from baseline, per cent)



Source: KPMG Econtech MM2 simulation.

5 Key Findings

The Investment and Financial Services Association (IFSA) has a view that the provision of quality financial advice has the potential to provide consumers with a more appropriate wealth management strategy. That is, IFSA contend that good advice can lead to a reduction in risk through diversification and a better match between an individual's risk profile, based on factors such as age and risk tolerance, and their portfolio of assets. These factors, as well as the financial discipline which comes from having a financial planner, have the potential to lift the saving of an individual. Higher saving by individuals lead to gains in household saving and hence national saving; higher national saving has important economy-wide implications.

An initial statistical analysis of investor data found that those with a financial planner save \$2,650 on average more each year than those without a planner (based on the level of contributions in the 2007/08 financial year). Controlling for other factors that can influence saving behaviour, it was estimated that those who have a financial planner save an additional \$2,457 each year compared to a similar individual who does not have a financial advisors/planners.

The results from this regression analysis was used to estimate the magnitude of the reduction in economy-wide consumption (gain in household saving) if additional 5 per cent of Australians receive financial advice. A gain in national saving increases the wealth of Australians. The higher wealth of Australians means there is less dependence on foreign financing of domestic capital. The economy-wide modelling shows that the increase in national saving leads to a reduction in foreign liabilities by 1.5 per cent of GDP than otherwise would have been the case.

The lower reliance on foreign investment in this scenario could lower the risk premium for investment in Australia, so that gains in business capital are sustained in the longer term. Reflecting the conservative nature of the modelling, this risk premium effect is not included, so that the gains in investment are medium term rather than long term in nature.

During the transition phase towards this higher domestic asset position there are important economic consequences. The majority of the gain in national saving finances a reduction in the current account deficit, while the remainder finances a gain in investment. The ongoing reduction in the current account deficit leads to the mounting reduction in foreign liabilities discussed above. In addition, a prolonged period of higher investment leads to mounting gains in the capital stock. These gains in capital stocks support gains in GDP.

Importantly, the advice provided by financial advisors/planners varies in quality. A survey of IFSA FAN members found that IFSA FANs survey respondent took measures to improve the quality of advice provided by their advisors/planners over and above those required by regulation. Table 5.1 provides a summary of the responses received from IFSA FAN members.

Table 5.1 Summary of KPMG Econtech Survey Results - Quality Aspects

Respondent	1	2	3	4	5	6	7	8	9
Training and Development	-	✓	✓	✓	✓	✓	✓	✓	✓
Compliance and Risk Management	-	-	✓	✓	✓	✓	✓	✓	✓
Product Research and Knowledge*	✓	✓	✓	✓	✓	✓	✓	✓	✓
Consumer Protection	-	✓	-	-	✓	✓	✓	✓	✓
Client Satisfaction^	-	✓	✓	-	✓	✓	✓	✓	✓

Source: KPMG Econtech Survey

✓ Indicates respondent exceeds regulations - Indicates respondent member meets regulations

*Responses recorded refers to Question 3a ^ Refers to whether or not respondent monitors client satisfaction

As can be seen from the summary table, the majority of survey respondents reported that they currently exceed regulatory requirements in most categories. The key results are as follows:

- Product research and knowledge regulations were exceeded by all respondents.
- Eight of nine respondents exceeded regulatory requirements for training and development.
- Six of the nine respondents exceeded the regulatory requirements for consumer protection.
- Five out of nine respondents reported that they exceed current regulatory requirements in all five categories.
- All respondents exceeded regulatory requirements in at least one of the five categories.

Appendix A – Survey Questions

IFSA Value of Financial Advisory Networks (FANs) Survey Questions.

Quantity Metrics

For customers with:

- Funds Under Management (FUM) greater than \$1000; and either
- a contribution has been received in the 2007/08 financial year; *or*
- a planner has phoned your organisation regarding the contract.

Please provide the following information in an Excel spreadsheet with each row denoting a separate customer.

- “Age”: Age of customer (years). For joint super accounts please use the age of the oldest member.
- “Gen”: 1 if customer is male or 0 for female. Leave this field blank for joint superannuation accounts except in those instances where the clients holding the accounts have a common gender.
- “Inc”: Income of customer during the 2007/08 financial year. For joint super accounts please use total income for both members
- “Sup”: FUM within Superannuation Account (\$)
- “Sup_F”: Increase in FUM within Superannuation Account in the 2007/08 financial year (\$)
- “Sup_C”: Member (including Spouse) contributions to the Superannuation Account over the 2007/08 financial year (\$)
- “Sup_E”: Employer contributions to the Superannuation Account over the 2007/08 financial year (\$)
- “Inv”: FUM within Investment Account (\$)
- “Inv_F”: Increase in FUM within Investment Account over the 2007/08 financial year (\$)
- “Inv_C”: Member contributions to Investment Account over the 2007/08 financial year (\$)
- “Oth”: FUM within other accounts e.g. bank savings or term deposits (\$)
- “Oth_F”: Increase in FUM within other accounts over the 2007/08 financial year (\$)

- "Oth_C": Member contributions to other accounts over the 2007/08 financial year (\$)
- "Pla": 1 if the client has a planner for more than 6 months in 2007/08 or 0 otherwise.
- *As we are trying to analyse the impact on savings of one-on-one planner relationships, please classify employer super clients, where the relationship is between the planner and the employer, as "0"*
- "Len": Length of relationship with current planner (years)
- "Pho": 1 if a planner has phoned your organisation regarding the contract or 0 if the planner has not phoned your organisation regarding the contract
- "FFS": 1 if in the 2007/08 financial year the client has a record of 'Fee for Service' (FFS) or 0 if otherwise
- "Ris": 1 if the customer holds a risk-related account or 0 otherwise
- "Ris_A": 1 if the customer holds any risk-related account that is personalised i.e. it is not a risk account automatically entered into as part of the superannuation contract or 0 otherwise.

If possible, please also include the following information. Where this information is not available please indicate with an 'N/A'

- "Emp": 1 if employed, 0 otherwise. If this information is not readily available please use SGC contributions as an indicator of whether or not a customer is employed.
- "S_Emp": 1 if self-employed, 0 otherwise. If this information is not readily available please use a Notice of Intent or business overheads insurance as an indicator
- O_Emp: 1 if neither employed nor self-employed, 0 otherwise
- "Mar": 1 if single, 0 if married
- "Chil": 1 if customer has children, 0 otherwise

Quality Aspects

1. Training and Professional Development

The regulations surrounding the training and professional development of financial advisers include:

- The Financial Services Training Package FNS04³⁰ – skills standards that apply to enterprises and individuals and to people working within the financial services industry.
- Australian Qualifications Framework
- ASIC Regulatory Guidelines 146³¹ – The Tier 1 education level is broadly equivalent to the ‘Diploma’ level under the Australian Qualifications Framework and the Tier 2 education level is broadly equivalent to the ‘Certificate III’ level under the Australian Qualifications Framework.

Does your organisation offer training and development programs over and above that required by regulation? If yes, please detail the types of programs that are available to financial advisors within your organisation.

2. Compliance and Risk Management

An AFS Licensee is expected to:

- comply with ASIC Regulatory Guide 104 – Licensing: Meeting the general obligations
- comply with ASIC Regulatory Guide 105 – Licensing: Organisational competence
- ensure that representatives undertake Continuing Professional Development (CPD) to maintain and update the knowledge and skills that are appropriate for their activities on an ongoing basis as required by RG 146.

In terms of Risk Management, does your organisation place additional procedures in place over and above what is required by legislation? If yes, please detail these additional procedures.

3. Product research and knowledge

The regulation surrounding the provision of advice for a particular financial product requires the adviser to first:

- Comply with ASIC RG 146

³⁰ <http://www.ibsa.org.au/content/financial/index.html>

³¹ [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg146v1.pdf/\\$file/rg146v1.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg146v1.pdf/$file/rg146v1.pdf)

- ensure that representatives undertake Continuing Professional Development (CPD) to maintain and update the knowledge and skills that are appropriate for their activities on an ongoing basis as required by RG 146.
 - i. Does your organisation undertake additional research on products over and above what is required by regulation. If yes, please outline this additional research.
 - ii. What proportion of your expenses is devoted to product research?
 - iii. How is this information on product research disseminated to advisers?

4. Consumer Protection

The regulations surrounding consumer protection requires that financial advisers meet their obligations by complying with ASIC Regulatory Guide 166 Licensing: Financial Requirements and RG 167.

RG 166 sets out the financial requirements that have to be met as AFS licensee. The requirements vary depending on the financial products and services offered. RG 166 only applies to institutions that are not regulated by APRA. Institutions regulated by APRA and not ASIC need to comply with the Australian Prudential Regulation Authority Act 1998. RG 167 sets out the required customer compensation arrangements, including professional indemnity insurance.

Does your organisation have a larger capital backing or professional indemnity insurance cover that is above what is required by legislation? If yes, please detail these additional consumer protection.

5. Client Satisfaction

Does your organisation regularly track client satisfaction formally? If yes, please outline the formal procedure in place.

Appendix B – MM2

KPMG Econtech’s forecasting tool, Murphy Model 2 (MM2), is Australia's leading national, industry and state forecasting model. It has a highly respected forecasting track record and is used by Federal and State Governments, industry associations, financial institutions and major companies. Subscriptions to forecasting reports and Windows-based forecasting software are available.

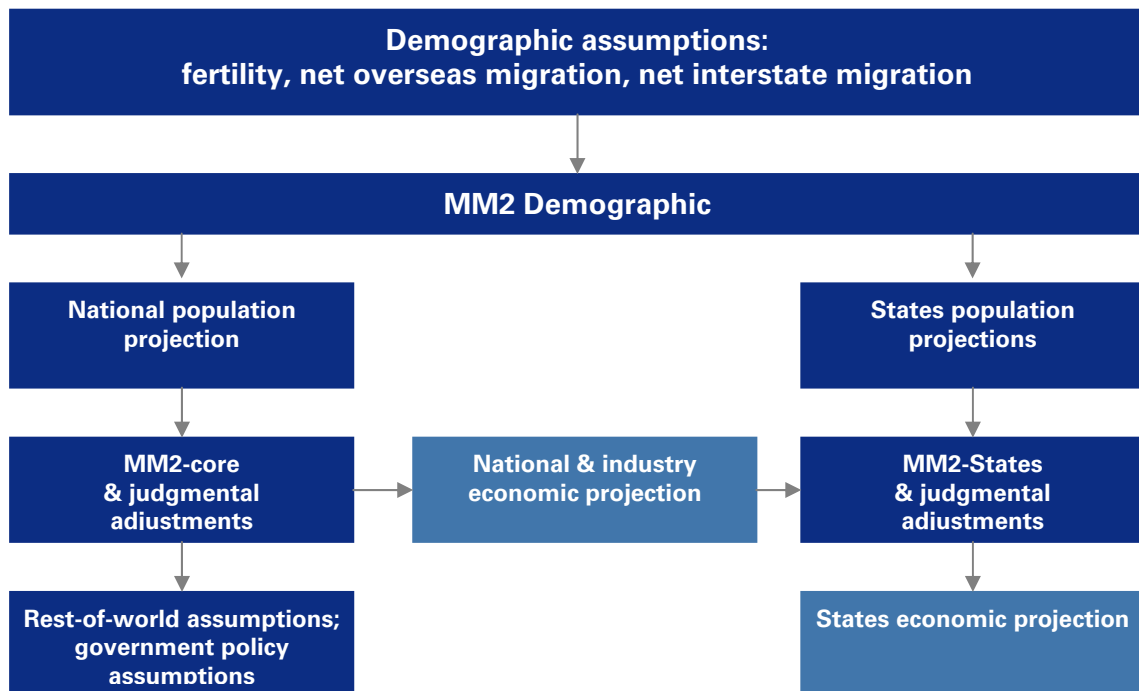
The original Murphy Model was developed by Chris Murphy, after ten years of experience in macroeconomic modelling at the Australian Treasury, Economic Planning Advisory Council, and the Australian National University. In 1988, Chris published the first version of the Murphy Model in Australian Economic Papers, and it was soon recognised as Australia’s leading macro model.

In 1994, the first major redevelopment of the model was undertaken to distinguish 12 industry sectors. This marked the introduction of the MM2, a fully integrated macro and industry model.

In 1995, under contract to two state treasuries, the MM2-States was developed as an extension to MM2. The MM2-States allocates a number of MM2’s key outputs across the eight Australian States and Territories.

In the same year, the current version of MM2-Demographic was developed under contract to the Australian Bureau of Immigration Research. Using assumptions for fertility, mortality, overseas and interstate migration, it generates consistent state and national population scenarios.

In 1996, the MM2 was further developed to expand the sectoral detail from 12 sectors to the 18 sectors corresponding to the Australian and New Zealand Standard Industrial Classification (ANZSIC) industry divisions. The linkages between the three models are illustrated below.



Features

MM2 is a state-of-the-art, fully-integrated macro-industry model with the following features:

- produces quarter-by-quarter nine-year-ahead forecasts;
- forward-looking financial sector for realism;
- Keynesian short-run for forecasting; and
- neoclassical long-run for policy analysis.

Documentation

Powell, A.A. and Murphy, C.W. (1997), *Inside a Modern Macroeconometric Model - A Guide to the Murphy Model*, Springer, Berlin, 2nd ed., 455pp.

Appendix C – Regression Results

The basic model used to calculate estimate the level of savings is expressed as:

Model A

$$Sav_t = a_0 + a_1PLA + a_2AGE + a_3SEMP + a_4OEMP + a_5MARCHIL + a_6Balance(ALL3) + a_7FFS + a_8Salary$$

where:

- Sav = Captures the level of savings for each individual in the 2007-08 financial year.
- PLA = A dummy variable to indicate if an individual has a financial planner or not.
- AGE = Details the age of the individual.
- SEMP = A dummy variable to identify if the individual is self employed or not.
- OEMP = A dummy variable to identify if the individual is neither self employed or employed.
- MARCHIL = A dummy variable to identify if the individual is married with/out children or not.
- Balance(ALL3) = Captures the total balance for all types of accounts held by each individual at the beginning of the 2007/08 financial year.
- FFS = The dummy variable to indicate if the individual paid a fee for a specialist service in the 2007/08 financial year.
- Salary = This variable captures the salary level of the individual in the 2007/08 financial year.

The regression results:

Dependent Variable: ALL3_C

Method: Least Squares

Date: 09/09/09 Time: 11:11

Sample: 1 845435 IF AGE<111 AND AGE>0 AND ALL3>0

Included observations: 726823

ALL3_C =C(1)+C(2)*PLA+C(3)*AGE+C(4)*S_EMP+C(5)*O_EMP+C(6)*
MAR_CHIL +C(7)*ALL3LAG1+C(8)*FFS+C(9)*SALARYALL

	Coefficient	Std. Error	t-Statistic	Prob.
C(1)	-9587.044	226.9707	-42.23914	0.0000
C(2)	2457.393	121.1205	20.28882	0.0000
C(3)	88.91018	4.599203	19.33165	0.0000
C(4)	8517.382	255.5968	33.32351	0.0000
C(5)	7312.346	128.9965	56.68641	0.0000
C(6)	168.6080	130.4930	1.292085	0.1963
C(7)	0.140595	0.000665	211.3739	0.0000
C(8)	18610.33	322.9770	57.62124	0.0000
C(9)	5.50E-06	1.83E-05	0.300785	0.7636
R-squared	0.074023	Mean dependent var		5553.083
Adjusted R-squared	0.074013	S.D. dependent var		52823.16
S.E. of regression	50830.78	Akaike info criterion		24.51040
Sum squared resid	1.88E+15	Schwarz criterion		24.51055
Log likelihood	-8907354.	Hannan-Quinn criter.		24.51044
F-statistic	7262.769	Durbin-Watson stat		2.024604
Prob(F-statistic)	0.000000			

Note: As the dataset is a cross-sectional and not time series, the key factor to consider is the statistical significance of the independent variables (as measured by the t-statistic). A low R-squared is considered acceptable under the conditions but not necessarily in times series regression modelling.