



Investment & Financial Services Association Ltd

## **Ernst & Young Asset Management Breakfast**

**Address by**

***Richard Gilbert, IFSA CEO***

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**Sydney, Australia**

## **Richard Gilbert- Ernst and Young Address**

Good morning and thank you for inviting me to present IFSA's views as to how we'd like to see 2008 unfold for the Australian financial services industry. Ladies and Gentlemen it is a pleasure to be here today to give what is becoming an annual event at Ernst and Young at this time of year. We very much enjoy a quality relationship with your firm as do many of our members, to whom you provide high quality services.

### ***Overview***

Australia is, as most people are now aware, the 4<sup>th</sup> largest managed investment market in the world with some \$1.3 trillion under management. Our 143 members are involved in and responsible for managing around 95% of that.

Arriving at this position has been a combination of the right policy and regulatory settings from government and our own unique 'Australian way' of product innovation and development. Long may this continue.

### ***New Government***

The political landscape has changed dramatically. With Labor in Government the 42<sup>nd</sup> Parliament will be a profoundly different place. A change of Government means just that - new bureaucratic machinery, different policy ideas, a natural view that what was in place before was not perfect. It presents tremendous challenges and opportunities for all of us, particularly for bodies such as IFSA that are in the business of representing industry views to Government, and lobbying support for positive improvements and changes.

We should not be jumping to conclusions that longstanding policies will continue. Nor should we automatically conclude that an election promise will be delivered in the next few months and with the same detail as might have been formulated pre the election. Politics and policy are inherently very fluid and constant advocacy will be the name of the game during the next three years if our industry is to continue to be heard in Canberra.

We will need to retain the things that work and, at the same time, we must broker new policy that adds value, boosts national savings, drives increased productivity and allows a dynamic financial services sector to carry on its fundamental role of creating wealth for investors and the Australian economy.

Of course, IFSA is in furious agreement with the new Rudd Labor government on issues such as the need to ensure that the window of opportunity to expand Australia's export of financial services is one that we seize with both hands ..... while that window is still open to us.

In some policy areas, it is no secret that we have had our differences with Labor, but to their credit, members of the new government maintained a constant dialogue with IFSA while in opposition - and I think it is fair to say that we have an effective working relationship as well as a clear mutual understanding on our respective positions. After all, there is an old saying that *'Diversity of opinion is the lifeblood of democracy'* and where there is dialogue, differences can often be worked through.

What is important in this regard is that at a 'principles level', we have strong agreement. The need for efficient regulation, the need to grow national savings and the need for strong consumer protection are matters for which there is agreement between the Government and industry.

### ***Australia's place in the world***

As well as being CEO of IFSA, another hat I wear is that of Chair of the International Investment Funds Association. We held the 21<sup>st</sup> Meeting of the IIFA here in Sydney just a few short weeks ago – if you like, a kind of mini-APEC of international funds associations from every continent around the world who are collectively responsible for managing over US\$24.5 trillion.

Thankfully, we were spared a visit from the boys at *The Chaser*, but in their absence we had 76 delegates from 35 nations turn up to discuss international investment, regulation and how to bolster industry integrity and thus build consumer confidence.

No matter what language we speak, these are universal issues of interest to us all.

International visitors working in funds management – and I might add - regulators who visit us as well - never cease to be impressed by the industry and the regulatory framework we have built here in Australia.

In a fast-moving world, our industry can never sit back and relax, particularly when faced with the election of a new government who as I have already pointed out, will want to make their mark and hit the ground running.

So turning to the domestic environment, I will now outline how IFSA believes we can build on what is already a thriving industry, brimming with innovative ideas and expertise, and to grow it further for the benefit of investors both domestic and from across our region – and of course for the benefit of the Australian economy as a whole.

And benefit the economy, we do. As an industry, we generate some 7.8% or \$67 billion of real gross value added, which is *more* than mining and almost as much as the mining, agriculture, forestry and fishing sectors *combined*.

### ***The 2008 agenda***

The 2008 agenda for IFSA is to ensure that the regulatory environment for business and the environment for consumers is both effective and balanced. Let me begin by making some remarks on IFSA's self regulatory code.

Signing on as a member of IFSA is a serious business decision. It is a decision of considerable gravity, because on becoming a member, a company agrees to mandatory compliance with our Standards and Guidelines – to be surveyed for compliance- and to be subject to the overview of the Standards Oversight and Disciplinary Board Committee if the code is breached.

Importantly, member companies sign off on IFSA compliance at board level.

By adhering to IFSA's Standards, member companies have undertaken to develop processes and products that provide investors with a quality assurance that goes beyond the base-line of the legislative and regulatory framework. IFSA Guidance Notes are in place to promote industry best practice and whilst not mandatory, many Guidance Notes eventually go on to become Standards after a period of bedding in, evaluation and refinement.

Member surveys show that 90% of respondents find Guidance Notes useful to their business. And talking of surveys, I am delighted to present you with an exclusive early release of the IFSA 2007 Compliance Managers Survey.

The 2007 Compliance Managers' Survey we are releasing today shows that:

- 97% of our member companies state that IFSA's Standards help them interpret their legal and regulatory obligations;
- 83% said that IFSA's Standards are seen as an integral part of their internal compliance and operating procedures.

When looking at how the Standards are integrated into member compliance processes:

- 70% integrate them within their compliance plans;

- 89% conduct ongoing monitoring;
- 82% subject them to verification (spot checks).

Notably, 100% of member companies stated that their Head of Compliance had responsibility for reporting breaches to IFSA.

I would now like to address some of the issues which our new Labor Ministers will have in their in-trays.

### **Product rationalisation**

For a number of reasons our industry has an excess number of financial products. For example, I am aware of one company that has 1,000 financial products, accumulated via mergers and acquisitions and also as a result of changing legislation. They say that they could work well with perhaps just 15 financial products. IFSA has been leading the charge, seeking changes to the legislation that would make product rationalisation easier - at no net detriment to the remaining investors in a legacy fund.

I am also aware of a fund with a single member - that's right, a single fund investor that a member company cannot shut down. The management, administration and compliance to keep this fund running must be in the order of more than \$130,000 per year.

I can be confident in saying that mergers and acquisitions are a permanent feature of our industry and, therefore, the number of legacy products is bound to increase unless there is quick action by government and changes made to the relevant laws. It is an imperative that we find a way of reducing the number of legacy products in the marketplace both to reduce investor risk and to improve efficiency.

### **MITR**

Labor has announced that they will initiate a review of the taxation of investment trusts in line with IFSA's submission on the managed investments tax regime. IFSA welcomes this announcement and looks forward to working

with Treasury and the Government on what should be very significant and timely reform. To this end the new Assistant Treasurer, Chris Bowen, made a much heralded speech at IFSA's 2007 Conference in August and this issue has strong linkages with Australia becoming a regional financial services centre. So we believe this will be a matter which our new minister will address with a degree of expedition.

### **Superannuation**

We welcome the appointment of the new Superannuation and Corporate Governance Minister, Senator Nick Sherry. Senator Sherry brings to the portfolio long standing and proven expertise in relation to superannuation, life insurance and funds management. He has spoken at numerous industry functions and conferences and importantly he is not on a steep learning curve. He will no doubt hit the ground running and add value to our industry very early in the life of the Rudd administration, and I can now report that in this capacity, the Minister gave his first public address to an IFSA luncheon in Melbourne last Thursday.

Senator Sherry has identified lost superannuation monies as an important priority that will no doubt keep us occupied in 2008. The ATO has recently reported that there are approximately 5.7 million lost super accounts with a total of almost \$10 billion in lost super. Moreover, the amount of lost super is *increasing*. In August 2007, the Parliamentary Joint Committee on Corporations and Financial Services, indicated that lost superannuation will remain a real problem for large numbers of providers.

The Committee suggested that good data collection and reporting by regulators and funds will be essential in order to devise further relief. To further explore the issue of lost super and analyse the various solutions being put forward, we have invited a distinguished panel of industry leaders to share their experiences and views. Solutions will be submitted to the new government when the opportunity arises.

During the election campaign, Senator Sherry spoke in favour of reform to assist Australia's low and middle income earners in bridging the retirement savings gap. We applaud his proposals that there be further enhancements to the co-contributions scheme as well as an amelioration of the impact of front end taxes on low income earners.

The 2008 Budget will be formulated in the midst of concerns that fiscal policy needs to address the twin threats of rising interest rates and inflation. Equally, there is an emerging political imperative for the new government to find a way of returning fiscal surpluses to the taxpayers who have contributed to the government coffers. Superannuation incentives are a proven means of transferring public wealth into private hands, but with only minimal impact on inflation and interest rates. The IFSA pre-budget submission will canvass this matter strongly.

### **Australia as a regional financial services hub**

Given the limited time available to us today, I would urge you to visit the IFSA website for more information on this issue. An early indication of the growing enthusiasm for this concept is the announcement by Prime Minister Rudd that he will initiate - and in some cases, lead - Ministerial delegations to countries throughout the region to assist us in our mission to grow Australia as a regional financial services centre. This is an area where the new Government appears to well and truly share IFSA's vision - and we welcome their support. Also welcome is the announcement that a Rudd Labor Government will halve the withholding tax rate to 15% for foreign sourced income for fund managers, bringing Australia into line with best international practice.

We look forward to the Government introducing this key initiative and we expect that early in 2008 there will be a raft of announcements in relation to financial services exports. IFSA anticipates that this will be a multi-ministerial policy area with the Prime Minister, Treasurer, Trade Minister, Assistant Treasurer and Minister for Superannuation all having a special role.

### **Takeover thresholds for funds management**

To compete in our region and internationally we need to have laws that are pro-competition and that operate efficiently. The practical operation of the threshold limits in the takeover requirements of our law significantly impact domestic investment opportunities for Australian funds managers and limit their ability to maximise returns to fund members. It defies logic that one of the reasons we talk about the need for funds to look offshore for investment is because of limited domestic investment opportunities, when those limitations are, in part, a product of threshold limitations imposed under our laws.

Australia, with a takeover threshold of 20%, is currently out of step with jurisdictions such as the USA, United Kingdom, Canada, Hong Kong and Singapore where the threshold is 30%. In addition, while there are differences in the takeover laws of the respective jurisdictions, each of these countries also permit disaggregation of holdings in specified circumstances.

The takeovers provisions of our laws need, in our view, to be amended to facilitate market efficiency and remove investment impediments that limit the potential financial returns to investors in Australian managed funds. It is a matter that we will pursue with the Government.

### **Stamp duty on life insurance**

Australia has a massive underinsurance problem and State stamp duties on life insurance products are not making these products any more affordable. In fact, I contend that these state duties should be abolished – both as nuisance taxes and because they go against the spirit of the Commonwealth/State arrangements under the A New Tax System legislation.

The states and territories need to come on board. One IFSA member has advised that for at least 6 months of the year, they have stamp duty auditors from the 8 states and territory Offices of State Revenue camped in their premises.

Surely we can do better than this. In one state, the cost of administration and member compliance *exceeds* the total revenue *collected*.

Until these stamp duties can be abolished once and for all - can we at least have a ***single regime*** with a rate that could be competitively struck? IFSA supports the statements made by Assistant Treasurer Chris Bowen and Finance Minister Lindsay Tanner on the need for uniformity in state regulation - including stamp duty. Hopefully, this matter will be addressed in the forthcoming May Budget.

### **Disclosure documents**

IFSA looks forward to working with the Labor Government in rationalising and streamlining our various disclosure documents. In the digital economy, a mountain of information is available electronically. Disclosure, in our view, should be premised by accessibility and not necessarily the production of voluminous paper documents.

While steps have been taken to shorten documents through the recent changes allowing incorporation by reference in product disclosure statements (PDSs) and statements of advice (SOAs), there needs to be a fundamental change in approach to disclosure that embraces the digital economy. For example, all regulated documents should be provided to clients electronically where an electronic address is held for that client. This is not currently the case. There is, in many instances, still a requirement for paper documents to be sent unless the client positively opts out.

This is an area where we should expect leadership from government. The financial services industry has developed and operates a sophisticated electronic delivery system that should be fully utilised.

The law *shouldn't* be the physical ball and chain on our electronic legs.

The wider use of electronic documents and the potential savings for both consumers and business are significant.

IFSA estimates over 100 million pages of paper or 530 tonnes of paper were sent out last year for super confirmations alone, resulting in over \$85 million in administration costs. In relation to annual reports the industry sends in the order of 35 million of these to its super and non-super investors. We know that these documents are not widely read. In the non-super area for example one company reported that out of 100,000 customers, *just 1200* requests were received for an annual report.

IFSA will push for this fundamental change in approach which will not only result in cost savings and greater efficiencies, but should also reduce our carbon footprint. The fact that Australia has signed up to Kyoto will give this issue impetus and IFSA members will now have an obligation to develop their emission reduction strategies in conjunction with good government policy.

### **Distribution and advice**

It will come as no surprise that IFSA believes that there is not enough acknowledgement as to the significant *benefits* of financial conglomerates and their advisory networks. IFSA will soon be releasing a paper looking at the structure and operation of Financial Advisory Networks. We believe that there is a lack of understanding within the media, government and public generally on the important role that FAN's play in assisting financial planners to meet their regulatory and professional obligations. FAN's are also there to help investors make informed and rational decisions when turbulent times or market downturns occur.

A core challenge is continuing to raise the quality and integrity of advice, and demonstrating how the quality of advice is improving through good research and administrative support.

In 2008, IFSA will establish a working group to develop Standards and Guidance Notes to provide guidance on fee templates and approved product lists. There will also be another working group established on Broadening Access to Advice, to work closely with the FPA.

This group will have linkages with the Value of Advice Working Group, to promote the value of advice to both consumers and the media. With the rapid growth in an individual's superannuation savings comes the increased need for financial advice. Successive governments have fostered the development of an Australian superannuation system that is the envy of the world. We have moved away from the paternalistic world of the defined benefit fund (characterised by large unfunded liabilities) to accumulation schemes (defined contribution schemes) where more responsibility is placed on the individual to grow their savings for a comfortable retirement.

Increasingly, within government and our regulators, there is recognition of the need for financial advice. Unfortunately, some of the impediments to the provision of advice can be found in our law. IFSA is recommending through FICA that amendments be made to the legal *definition* of advice to enable the broader *provision* of advice. The current definitions and requirements imposed on the provision of advice result in lengthy written disclosures and additional costs. This has put financial advice outside the reach and comprehension of many Australians who are in most need of advice. Our recommended changes to the advice definition will, we believe, facilitate the broader provision of financial advice without compromising integrity or investor protection.

### **Investor education and financial understanding**

My final point concerns financial literacy. IFSA will continue to work toward consistency in the use of industry terminology. We will also continue to support the work of the Financial Literacy Foundation in order to help raise the levels of financial literacy in the Australian community. It is to be hoped that bipartisan support for the Foundation continues and that the educational material developed for inexperienced investors can be further rolled out into workplaces and other forums where it will be valued.

Thank you once again for your invitation today, and may you long continue as a firm to deliver quality in everything you do.

