

# *Shaping the future of our industry*

*Financial Services Council/  
PwC CEO Report*

*July 2011*



**pwc**

*What would you like to grow? .....*

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# Foreword



## John Brogden

Chief Executive Officer  
Financial Services Council

The Financial Services Council/PwC CEO Report 2011 captures the views of leaders in the Financial Services sector on the key economic, regulatory and investment policy issues.

The Financial Services industry in Australia manages \$1.8 trillion. Australia's funds under management are now larger than the capitalisation of the Australian Stock Exchange and larger than the GDP of the nation. As a result Financial Services is also Australia's largest industry, constituting 10.8 per cent of GDP. The Financial Services sector also plays a pivotal role as the aggregator and allocator of capital in the Australian economy.

The policy issues faced by the Financial Services industry are therefore central to the Australian economy. Issues such as an ageing population, tax and infrastructure reforms and Australia's role in Asia are all raised by CEOs as key challenges for the industry and government.

This year's Report highlights the high levels of frustration at the uncertainty in the regulatory change agenda. It also reveals that global economic factors are weighing on CEOs' minds as is the need to restore consumer confidence.

These concerns are interrelated and represent important messages for the industry and policy makers. Investment decisions are being adversely affected by this sentiment. It is therefore critical that the reform agenda is settled as quickly as possible to provide certainty for both the industry and consumers.

**\$1.8**  
**trillion**  
*funds under management*

# Executive Summary

**Welcome to the 11th annual Financial Services Council/ PwC CEO Survey. This year's survey captures the views of 31 CEOs representing approximately 80% of Australia's total assets under management and including the top ten wealth managers.**

The regulatory reform agenda for the industry is significant. There is little doubt that we are witnessing a time of fundamental change right across all sectors of the industry, particularly as a result of the Stronger Super and FOFA reforms. While CEOs were generally supportive of the objectives of these reforms there was concern about potential unintended consequences and some frustration about the time being taken for the reforms to be finalised.

CEOs continue to be concerned about the future economic and social impact of an ageing population and the size of the current "retirement savings gap" which is estimated to be \$897 billion. They acknowledge that the Government's commitment to increase compulsory superannuation contributions will go some way towards closing this gap but believe much more still needs to be done.

There was an increasing focus on Asia as a potential source of future growth and strong support for the establishment of an Asia Region Funds Passport. CEOs acknowledged that there is strong competition from other financial centres across the region but consider that the size and sophistication of our industry has allowed us to innovate and develop skills and expertise which are in demand across the region.



**Andrew Wilson**

Wealth Management  
Industry Leader  
PwC

**Through its size and influence the industry has an important role to play in helping to shape economic, regulatory and investment policy issues in a way that will assist in securing the future retirement outcomes of all Australians.**



# Survey Snapshot:

*Despite the significant short to medium term challenges, the longer term outlook for the industry is strong.*

The industry is ready to address the key challenges, including the regulatory reform agenda, restoring investor confidence and global macro issues.

#### CEOs are feeling:

- **optimistic** about the future of the industry and the regional opportunities that are emerging
- **frustrated** by the uncertainty in the regulatory change agenda
- **concerned** about the economic and social impacts of an ageing population
- **respectful** of the trust placed in them by investors

#### Key survey findings include:

**15%**

*Increasing both mandatory and voluntary contributions is key to improving the adequacy of retirement savings – contributions should be at least 15% of income*

**0%**

*No CEO's are confident in Australia's approach to infrastructure*

**73%**

*73% of CEOs see Asia as an important source of growth*

**68%**

*68% of CEOs consider the industry should invest more in infrastructure*

**95%**

*95% of CEOs consider that the infrastructure initiatives outlined in the federal budget did not go far enough*

**94%**

*94% of CEOs are supportive of the establishment of an Asian Region Funds Passport*

**82%**

*82% of CEOs believe an Asia Region Funds Passport will support the growth and prosperity of the industry*

**71%**

*Tax reform is needed – 71% of respondents consider the current tax system impedes growth*

*CEOs welcomed those FOFA initiatives that improve the professionalism and transparency of the financial planning industry*

*There was concern that MySuper would result in further member disengagement and a 'dumbing down' of asset allocation*

*Superstream is critical to improving efficiency and reducing costs across the industry.*

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# CEOs' vision for the industry

## What will the industry look like in 20 years?

We asked CEOs what the industry and consumer might look like if we were to wind the clock forward 20 years to when it is estimated the industry will be managing over \$5 trillion.



### Industry

- more global players
- larger organisations
- more specialised
- more regulated
- more players doing business in Asia

### Consumers

- more engaged
- more sophisticated
- lower savings gap
- better diversified in investment exposures
- greater focus on ESG factors in investment decisions
- more investment in infrastructure

## What are the top 3 objectives for your organisation?

We asked CEOs for the top 3 objectives of their organisations over the next five years to support and enable business growth. The results are consistent with PwC's recent global survey<sup>1</sup>, which highlights the need for organisations to respond to the evolution of their clients. Clients are becoming more cautious and discerning, less trusting and loyal and demanding better service and clearer value. In addition, globally, organisations are making significant investments in technology primarily as a result of changing client demands, new regulations and a legacy of under investment.



<sup>1</sup> Anticipating a new age in wealth management: Global Private Banking and Wealth Management Survey 2011, PwC

## Top 3 challenges facing the industry today

We asked CEOs to tell us the top 3 challenges facing the wealth management industry over the next 5 years and what, if anything, the industry and government should be doing to address these challenges. The three most commonly cited challenges were:

**1** Volume and scale of the regulatory change agenda

**2** Restoring investor confidence

**3** Global macro issues – market volatility and uncertainty

Other challenges raised include talent management, member engagement, development of retirement/longevity products and industry consolidation.

## What should be done to address these challenges?

CEOs were cognisant of the enormous trust placed in them by investors to manage their retirement savings. They welcome effective initiatives to raise the bar on the industry's performance and continuously improve investors' confidence and trust.

CEOs understand that the industry is in a privileged position with mandated minimum superannuation contributions, which will continue to drive growth and they understand that the industry

needs to be well regulated to secure Australians' retirement savings.

Nonetheless, CEOs were frustrated by the uncertainty regarding the proposed regulatory reforms and were keen to obtain greater clarity from the Government.

The decisions around this reform agenda need to be based on achieving appropriate policy outcomes, focused on the best interests of investors. There are concerns that some of the proposed reforms may have longer term unintended consequences.

The reforms should be gradually introduced to allow industry participants time to adjust and implement.

CEOs believe the integrity of the industry needs to be beyond reproach. This could be achieved through improved transparency and professional standards, together with increased focus on risk/reward – not just fees.

The industry should work with Government to articulate a clear long term vision for the industry - focused on good policy so as to avoid unintended consequences.

## The future of the industry

While there were concerns about the short to medium term challenges facing the industry the longer term outlook was generally positive. Profit growth is expected to result from:

- Mandatory super contributions
- Product innovation
- Opportunities in Asia
- More efficient and effective operations



# National savings – Superannuation and funds management

*Only 18% of respondents were confident in Australia’s approach to addressing the challenges of an ageing population – this was a significant decline from 2010, where 44% were confident. CEOs are concerned that the economic and social impacts of the ageing population may be much greater than currently anticipated.*

## Boosting national savings

Despite having had compulsory superannuation for more than 20 years, Australia continues to have a significant retirement savings gap and must face the challenges of an ageing population.

By 2056 one quarter of the population will be older than the current retirement age<sup>1</sup>. It is estimated that the shortfall between the current savings rate and what is needed to sustain a reasonable lifestyle after ceasing work is \$897 billion<sup>2</sup>. The proposed increase of 3% in the compulsory superannuation contribution rate would only reduce this deficit by \$237 billion<sup>3</sup>, hence more needs to be done to address this issue. CEOs believe that competing Government policy priorities, public apathy and lack of engagement with superannuation are key barriers to addressing this issue.

Whilst increasing the compulsory contribution rate is viewed as a key component in addressing the national savings gap, demonstrating the value of advice and improving confidence in superannuation are also important factors to encourage voluntary savings.

A consistent message is that the frequent changes to the regulatory regime lead to uncertainty and diminish confidence in the system. In this regard CEOs commented on the challenges inherent in our relatively short terms of government resulting in frequent changes to public policy.

CEOs had a number of ideas to boost Australia’s national savings. Their ideas focus on increasing savings both inside and outside superannuation, including:

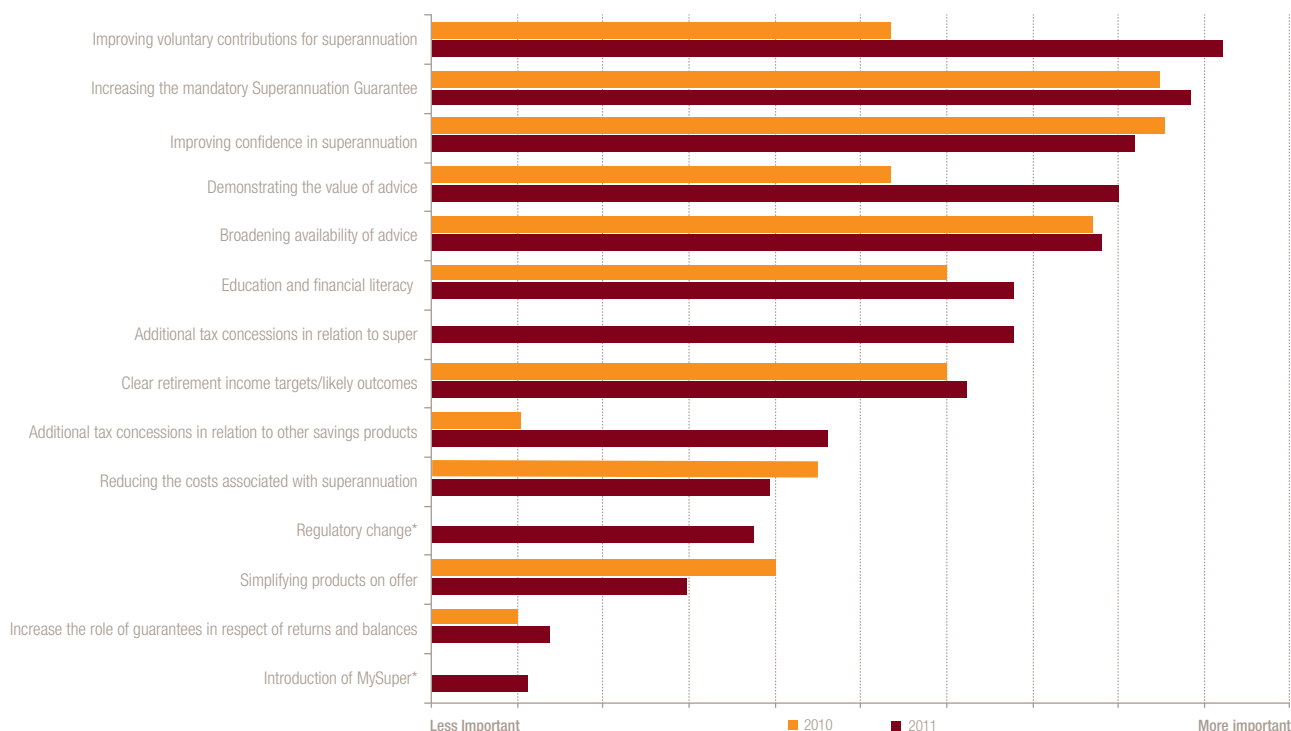
1. Increase the Superannuation Guarantee rate – most CEOs consider that at least 15% of income should be contributed to superannuation to achieve an adequate retirement outcome. Some suggest it should be phased – lower at a younger age and higher as people approach retirement
2. Create more tax incentives to encourage savings both inside and outside superannuation – although CEOs conceded there are already significant tax incentives in the superannuation regime and therefore it is unlikely there will be additional tax incentives made available
3. Encourage and support an older workforce
4. Improve the range and availability of retirement income products – this will become increasingly important as more people move from the accumulation to the retirement phase
5. Educate consumers and simplify superannuation.

<sup>1</sup> Population Projections, Australia, 2006 – 2010, 2008, Australian Bureau of Statistics

<sup>2</sup> Superannuation Adequacy prepared for IFSA, 2010, Rice Warner Actuaries

<sup>3</sup> Superannuation Adequacy prepared for IFSA, 2010, Rice Warner Actuaries

## How important are each of the following in improving the adequacy of retirement savings?



### Improving the adequacy of retirement savings

CEOs views on key ways of improving the adequacy of retirement savings have changed quite significantly from 2010. This year, increasing both voluntary and mandatory contributions were ranked as most important by almost all CEOs, likely reflecting the lower net flows into investment products during and subsequent to the global financial crisis.

Demonstrating the value of advice and improving confidence in superannuation were also seen as important, as can be seen in the above chart.

### Stronger Super

The Government's package of reforms to superannuation (Stronger Super) was widely discussed.

SuperStream, the package of reforms designed to improve the efficiency of back office functions across the industry, is seen as critical to improving efficiency and reducing costs across the industry, particularly improving data quality, the use of tax file numbers (TFNs) as a primary identifier and requiring the use of technology to improve processing efficiency. However, there were concerns about the challenges associated with consolidating multiple superannuation accounts - particularly in relation to potential impacts on insurance cover.

Other Stronger Super reforms that were seen as positive were increased regulation of Self Managed Superannuation Funds (particularly restrictions on in-house assets and collectibles as eligible investments) and capital requirements for superannuation funds (ie. operational risk reserves).

CEOs generally did not support the MySuper initiatives, being the establishment of a new low cost and simple superannuation product to replace default funds. They are concerned MySuper will result in further member disengagement and a 'dumbing down' of asset allocations by encouraging moves to more passive/index style investment allocation. However, this view was not universal, with one CEO commenting that MySuper enables funds to provide relevant solutions to those members who need very simple superannuation.

Nonetheless, CEOs seemed to accept that the Stronger Super reforms were likely to eventuate and were therefore positioning their businesses to respond.

**“All superannuants are entitled to consistent, high quality oversight of their retirement savings – especially as contributions are mandatory.”**

## Industry growth

We asked CEOs to look to the future and the potential sources of growth for their asset management businesses in addition to superannuation. The responses included:

1. Expansion/exporting talent/expertise to Asia and globally
2. Private wealth/tapping discretionary savings, including outside of superannuation given the contribution caps in place
3. Exchange Traded Funds
4. Not for profit enterprises
5. Emerging market funds
6. Infrastructure investing

Clearly the industry is exploring a range of different options for further growth in the future. This will be especially important for asset managers as most believe fund management fees will continue to come under pressure with decreases of up to 30 bps over the next 3 years.

## A vision for the future

Boosting national savings is a large and complex objective – the industry needs to work closely with successive governments in order to achieve the best retirement outcomes for Australians. The Government has some significant policy initiatives that it believes will go some way to addressing the national savings gap and it has been open to consultation with various parts of the industry. The more the industry can unite and present a consistent message to Government, the better it will be able to inform public policy and formulate a clear vision for the industry.

**“Boost flexibility of access to super, but restrict use to long-term benefit drivers (eg. home equity for younger savers, but with restrictions on subsequent access).”**

**“Increased use of target date funds or outcome oriented instruments will help boost Australia’s national savings.”**



## **PwC Insight – Longevity products**

*The industry has raised concerns and suggestions for tackling Australia's ageing population. The need for longevity solutions has also been receiving much attention. Historically, the take-up of longevity products such as annuities has not been as high as offshore markets (eg. US and UK), reflecting a number of structural features of the Australian market (eg. Australia's relatively comprehensive social security system, the predisposition of retirees to take relatively modest superannuation benefits as lump sums) and the availability of competitive interest rates for bank deposits.*

*Support from the Government, for example in areas such as tax and social security reform, is likely to be needed to encourage meaningful innovation in longevity products at least in the short to medium term. The development of a substantive retail bond market and the incorporation of global practices in areas such as deferred annuities and life insurance may well be required to support additional impetus for innovation in the longer term.*



“

***Clearly those closer to retirement and without the advantage of being in a 9% world from their first job should have higher caps. ”***

# Financial advice

**CEOs acknowledge the importance of providing consumers with access to affordable advice. There is also a belief that the industry has lost ground with consumers, particularly in light of a small number of high profile investment failures. The industry needs to take action to rebuild trust and increase awareness of the value of quality financial advice.**

## Improving access to and quality of advice

Some of the suggested areas of focus to help improve access to and quality of advice include:

1. Measures to reduce the cost of advice. Suggestions to help reduce the cost burden for consumers included providing tax deductions for financial advice or improving access to existing superannuation monies as a means of funding advice fees. Most CEOs considered that the proposed regulatory changes would not reduce the cost of advice
2. Effective rollout of scaleable advice models and greater exploitation of low cost direct and digital distribution channels. The CEOs had a strong view that whoever successfully achieved a scaleable advice model would have a distinct competitive advantage

3. Continuing to raise advisor professional standards, including introduction of mandatory professional body membership and improved technical training - CEOs considered that this would likely be a prerequisite to tax deductibility of advice
4. Greater government emphasis on educating consumers on the role and value of advice.

There was a feeling that the industry had already taken considerable steps towards improving standards although these will take time to become fully effective.

Increased legislation in this area was viewed as unnecessarily punitive. Some CEOs believe that the heritage of the industry and the lack of formal qualifications of many experienced planners needed to be acknowledged – it being unfair to penalise financial planners for meeting acceptable, albeit lower, standards in the past.



## Regulatory and market developments

Mixed reactions to the Government’s proposed Future of Financial Advice (FOFA) reforms were evident in the CEOs’ responses, with support for the broader package of measures far from unanimous.

The introduction and expected take-up of scaled advice and the proposed duty for advisors to act in their clients’ best interests were in the main viewed positively.

CEOs were divided on the benefits of banning commissions on superannuation and managed investments along with volume related payments to financial advisory networks and financial advisors.

Less popular was the ban on commissions on risk insurance inside superannuation. Australia’s level of under-insurance and possible distortions created by allowing commissions to be charged on insurance outside of superannuation were cited as key reasons for this disapproval.

There was also concern regarding the additional cost imposed and perceived lack of benefits of the proposed ‘opt-in’ measures (requiring financial advisors to obtain the biennial agreement of their clients in order to charge for ongoing advice).

Nevertheless, on balance, the cost of advice was expected to remain relatively unchanged, though there was an expectation that the cost of advice for high net worth investors would reduce whilst it would increase for small retail investors.

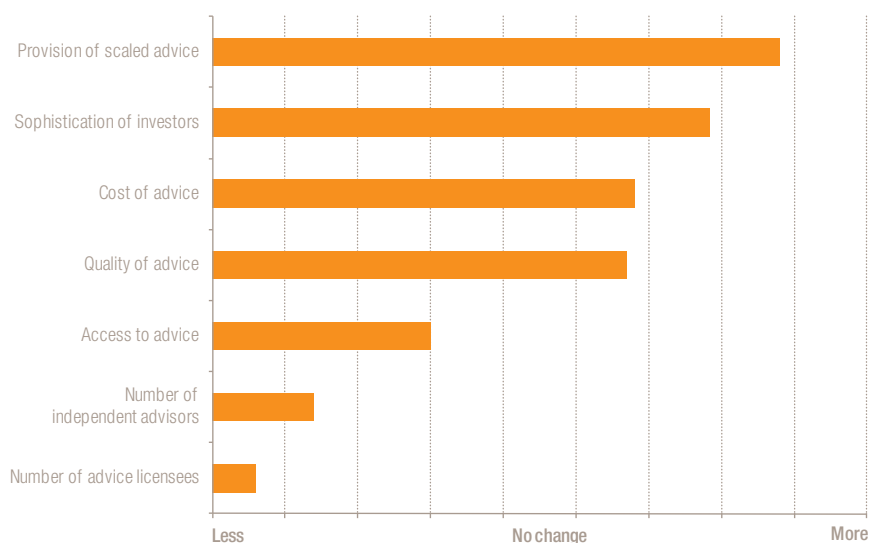
The sophistication of investors and the quality of advice were both forecast to increase. Most CEOs anticipate a reduction in the number of independent advisors and licensees (due primarily to the burden of increased regulation, in addition to the ageing of the financial planning cohort).



**“Reduce regulatory barriers making advice accessible to consumers that have simpler needs and prefer ‘bite-sized advice’ rather than holistic.”**



### How different do you believe the industry will be in the next five years?



## **PwC insight**

*There is little doubt that we are witnessing a time of fundamental change in the Australian financial planning and advice industry. The Government's FOFA and Stronger Super reforms, its commitment to increase the compulsory superannuation contribution rate from 9% to 12%, the current spate of M&A activities amongst financial planning dealer groups and superannuation funds, not to mention changing investor behaviours following the Global Financial Crisis, are re-shaping the industry.*

*In light of ongoing industry debate, we are unsurprised with the CEOs' concerns regarding the proposed opt-in mechanism and the ban on upfront and trailing commissions on life risk insurance within superannuation. Further, concerns regarding the additional cost burdens of the proposed reforms, whilst not unanimous, also reflect current debate within the broader industry.*

*Whilst views on the impact of these proposals diverge, a material number of industry players argue that the measures will increase the cost of providing financial advice and reduce the capacity of independent and non-aligned groups to operate profitable planning and insurance practices. The view that the reforms will favour vertically integrated business models would seem to have validity, at least in the absence of proactive measures and innovation from the more specialised players.*

*Further, it is now clear that the proposed ban on volume related payments from platforms to dealer groups and advisors will impact the viability of business models reliant on these payments.*

*Importantly, we are already seeing a considerable number of players re-engineering operating and distribution models to ensure ongoing viability of their businesses, in addition to ensuring they can continue to profitably meet the increasingly complex financial advisory needs of consumers.*



***“A financial planner has to be able to determine how to charge for the services provided. Government intervention (or direction) in charging methodology is inappropriate.”***

***“The cost of advice will be transparent. This is the right outcome but it has to impact the advice availability.”***

***“I cannot understand any circumstances where the opt-in reform will actually improve the quality of advice or the advice process or deliver the outcomes noted in the FOFA document released by the minister.”***

# Insurance

*The life insurance industry is facing some significant challenges, including chronic levels of underinsurance in Australia and major regulatory change both domestically and globally, coupled with continued pressure to generate reasonable returns on investment. CEOs are particularly grappling with the interplay of these factors, some of which are beyond their control.*

## Responding to Australia's underinsurance

It is estimated that as at June 2010 the level of underinsurance was \$669 billion to meet the subsistence needs of families and dependants after death. This is a significant improvement on the 2005 estimate of \$1,000 billion.<sup>1</sup>

While the level of underinsurance in Australia appears to be improving, CEOs continue to be concerned. They suggested initiatives that the industry and government could undertake to improve Australians' level of life insurance cover, including:

Industry	Government
Improve accessibility through making it simpler to access insurance products eg. go direct not just through plans, make scaled advice successful	Introduce some form of compulsion (with opt-out)
Develop simpler products and improved levels of default insurance	Improve education
Provide more education and promote buying, rather than selling	Improve and standardise tax deductibility and remove or simplify stamp duties
Develop more flexible products eg. portable in and out of super, life cycle products – including group rates, life stage funds, tailored insurance to reduce premiums	

## Improving efficiency in the industry

CEOs were mindful of the need to improve efficiency in the industry, some of which would happen with increased scale and ongoing product rationalisation, however other initiatives include:

1. Improving the issuing/underwriting process, for example, electronic medical health database access should be available
2. Enabling clients to have portability of like for like insurance cover when they transfer their superannuation account without having to re-undergo underwriting
3. Improve administration – data quality issues exist across the industry
4. Restructure commissions to neutralise the issue of adviser churn.

<sup>1</sup> Life insurance gap beginning to close, Rice Warner Actuaries

## Standard product terms and definitions

While 53% of respondents believe standard product terms and definitions should be developed, it was the CEOs of the life insurance companies who were strongly against standardisation.

These CEOs noted the benefits of standardisation, being simplification and potential for increased consumer understanding. However, they considered the impediments outweighed these benefits, including that standard terms may commoditise the product further and reduce competition and differentiation. This has been the experience in the United Kingdom.

Also, definitions interplay between each other. For example, two products with the same Total Permanent Disability definition with one having been issued under a pre-existing exclusion and the other granted under an Automatic Acceptance Limit, will operate completely differently at claim time – potentially one claim will be paid whilst the other will not.

Other impediments noted include the existence of back books and the cost of change.

Some suggested the industry should develop best practice guidelines rather than legislative definitions.

## International developments

With increasing globalisation, CEOs are mindful of international insurance developments, those of most concern to CEOs were:

1. European Gender Directive – pursuant to which the European Union will ban different premium rates for different classes of people, eg. male versus female. The business of providing insurance involves assessing the risks of groups of people and charging them according to their assessed level of risk – this necessarily involves discriminating against different groups. Many CEOs commented that the most likely outcome of the European Gender Directive would be that women pay more for their insurance
2. Cost and complexity of managing reinsurance given the increasing impact of natural disasters and contagion risk
3. Increased capital requirements as part of the global regulators' responses to the global financial crisis and particularly a one size fits all approach
4. Increasing commoditisation of life insurance products – the proliferation of online aggregation sites in the UK has driven very vanilla product development which means that new products developed to meet changing consumer needs for insurance are not successful as the comparison focuses largely on price. This leads to a product that, whilst cheap, may mean many consumers are not appropriately protected by the product at claim time
5. Government bail out may mean insurers are less concerned with risk mitigation as they will always be supported.

### PwC insight

*Australians continue to be chronically underinsured. This is of concern to the industry but should also be of concern to governments as the population ages – ultimately resulting in increased reliance on the pension as governments become the insurer of last resort.*

*There is a clear need to improve Australians' understanding of the value of insurance, and the FSC's Lifewise campaign is a great example of how to address this. Similarly, default insurance within superannuation is an effective measure to improve the level of cover, though neither are sufficient on their own.*

***“Innovate in product design and distribution to reach alternative and under insured segments – eg. stay at home parents.”***

# Opportunities in Asia

**Recent Government initiatives are supporting the industry's opportunities in Asia, including reduced withholding tax, recently announced proposals for an Investment Manager Regime, and the drive to establish an Asia Region Funds Passport. The anticipated benefits to Australia include increased investor choice, growth in regional jobs and expertise and improved efficiencies and cost reduction.**

## Asia as a source of growth

68% of CEOs see Asia as an important source of growth for their organisation. By excluding global organisations who indicated growth would come through their offshore operations, this increases to 82%. Activity to expand in the Asia region includes:

1. Joint ventures, both directly into Asia and via other offshore locations
2. Broadening the organisation's footprint in the region, for example, building distribution and funds management teams and developing alliances
3. Business acquisition opportunities
4. Establishing domestic funds feeding into UCITs compliant vehicles (and one day Asia Region Funds Passport vehicles)
5. Leveraging Australian intellectual capital.

Where respondents were part of a global organisation that already has offices and offers product ranges in the Asia region, the opportunity is not so much for foreign product growth for the Australian business but is more about attracting foreign investors into Australian funds and leveraging regional efficiencies.

Key actions required by industry to fully realise the opportunities in Asia are to better understand the region and how to invest across it and continue to be at the forefront of innovation.

Key actions required by government are to remove tax uncertainties and barriers, while also introducing appropriate tax incentives, and reducing tax compliance and regulatory administrative burden. This will serve to reduce the cost of doing business in Australia and increase mutual recognition between regulators in Asia.

## Asia Region Funds Passport

94% of CEOs are supportive of an Asia Region Funds Passport, and 82% believe it will support growth and prosperity of the industry. Understandably, some have doubts as to whether it will be established, several CEOs noted that there is only upside in this proposal so there should be no opposition to it being established.

While there was much discussion about the geographic remoteness of Australia from Asia, it was widely acknowledged that the time zone advantage relative to Europe and the United States is real.

Key barriers to Australia becoming a financial services centre are tax, geography and culture (not seen as integrated in Asia), regulatory regime, size of our domestic market and well-established global competitors.

## The opportunities – growth and a pension crisis

The economic and demographic fundamentals of the Asia region support the view that it will be the “future growth engine” of the global funds management industry. The region has over 60% of the world's population and Gross Domestic Product is forecast to grow at almost double the rest of the world over the next 5 years. The ageing of its population will be at its most rapid between 2010 and 2030 and it has a middle class that has grown and continues to grow faster than other world regions. It is widely considered that Asia is facing a pension crisis that will be its biggest social and economic challenge in the 21st century.

While Australia is a very open trading economy, our exports and imports of financial services as a percentage of GDP are, by international standards, low. The opportunities for leveraging our financial services skills and expertise, in the region and beyond, are enormous. For example, the percentage of funds under management sourced offshore in the UK, Hong Kong and Singapore are 31 per cent, 64 per cent and 80 per cent respectively. While in Australia it is estimated to be around 11 percent.

## What is our competitive advantage?

Most CEOs were of the view that the industry's opportunity across the region is multi-faceted. It was not about a niche offering in one sector – such as the way Luxembourg has established itself across Europe as an administration hub. It is about looking across the spectrum of skills and expertise that Australia has available to export and connecting them to the needs of the region. We are seeing a number of organisations already doing this. For example:

- fund managers with sub-advisory relationships with distributors in countries across the region
- distribution/sales offices have been established in countries across the region
- joint ventures with organisations able to provide distribution and brand strength
- overseas investors investing directly into Australian investment products
- niche asset management skills in areas such as infrastructure and real estate are attracting investment from other countries.

The size and sophistication of our industry has allowed and continues to allow us to innovate and develop expertise that is in demand across the region. Examples include:

- platform technology
- retirement products and annuities
- asset management – in particular, infrastructure and real estate
- hedge funds.

These are the areas where Australia should be competing – we have an exportable competitive advantage.

## Government support

Recent Australian government initiatives, such as reducing withholding tax, proposing an investment management regime, promotion of an Asia Region Funds Passport and the establishment of the Australian Financial Centre Forum are crucial to supporting opportunities across the region. The Government, through continued consultation with industry must continue to drive such initiatives.



### PwC insight

*We have long discussed becoming a financial services “hub” within the region. The concept of a hub suggests centrality within the region and low cost/high volume flow-through transactions. However, Australia does not have a competitive advantage needed to become a hub relative to other financial centres such as Singapore and Hong Kong, particularly in key areas such as cost structures, tax, regulation and approaches to banking secrecy. The wealth management industry in Australia is the largest and amongst the most sophisticated in the region. It has a wide range of exportable skills and expertise to leverage across the region.*

*This year's survey highlighted the industry's increasing focus on Asia for potential growth. Profitable growth in the Australian market is likely to become more challenging in the future as regulation, competition, demographics and other factors compress margins, increase the costs of doing business and force the industry to both innovate and seek new fields of play in Asia.*

# Infrastructure

***Australia clearly has a need for significant infrastructure development and many CEOs see the alignment between the funding requirements and time horizons for infrastructure investment and superannuation. Nonetheless, all CEOs saw their fiduciary obligations to invest in the best interests of members as overriding any obligation of superannuation funds to address the nation's need for infrastructure investment. Clear federal and state government commitment and vision are vital to achieving adequate infrastructure investment.***

## **Superannuation fund investment in infrastructure**

68% of CEOs considered that the industry should invest more in infrastructure, though many highlighted the need for the risk/return to be appropriate before this made sense. Some CEOs believe that the wealth management industry should contribute to infrastructure investment as it has been given concessions over a long period of time.

However, CEOs did not consider a mandate to invest in infrastructure to be appropriate, with one CEO commenting that a mandate to invest in such projects may diminish the notion of 'fiduciary responsibility' as it may not be in the best interest of investors. In addition, one respondent considered that infrastructure investment is already high by international standards so there was no imperative to increase investment in infrastructure.

Finally, some CEOs raised the concern that if there was a mandate to invest in infrastructure, this may be the thin edge of the wedge – asking 'what next' after mandating investment in infrastructure, then perhaps mandating investment in any government initiative.

## **Government action**

No respondent was confident that Australia's policy approach to infrastructure would meet our future needs and 95% of respondents considered that the initiatives outlined in the Federal Budget do not go far enough to encourage investment in infrastructure. While they are going in the right direction, there is no congruent public policy and limited opportunity to make projects attractive. There appears to be a lack of commitment and vision.

A suggestion from a number of CEOs was that projects could be structured such that the government takes all or some of the development risk and then privatises infrastructure investment after the development phase – this would improve the attractiveness of infrastructure investment.

One suggestion was that the government could pre-sell the project using a "collar and cap" style pricing mechanism which is dependent on realisation of certain development or operational outcomes, thereby sharing the development risk.

## Key barriers to infrastructure investment

Consistent with last year's survey, CEOs still see a number of key barriers to increasing investment in infrastructure. They included:

1. **Focus on short term performance** by investors versus the long term investment required in infrastructure
2. The desire for **daily unit pricing** and ability to redeem at call while infrastructure is an illiquid asset class and difficult to value on a daily basis
3. The **scale and complexity of infrastructure** transactions. Infrastructure Australia has a number of working groups in place to attempt to address these impediments (eg. probity issues, timelines, tender process, bid costs, project pipelines)
4. **Lack of confidence** due to recent high profile infrastructure projects where patronage was less than was expected when the investment decision was made
5. As the industry moves further towards **lower fees**, it becomes more difficult for a fund to invest outside of listed markets where transaction costs are relatively low.
6. **The political system** with inconsistent decisions potentially being made by parties at the local, state and federal level, coupled with changes in the governing party of the day.

It may be that the MySuper proposals reinforce some of these barriers to infrastructure investment, particularly given the focus on reduced fees and the continuing regulatory requirement that investors can switch funds within a very short timeframe.

## PwC insight

*CEOs commented that they have had numerous conversations with Government about how to encourage more investment into infrastructure and that it is certainly high on the Government's agenda. It is the long term nature of infrastructure that gives it both its appeal to superannuation and other long term investors but also its risk and complexity.*

*One of the main challenges with infrastructure investing is that the unsuccessful projects receive an enormous amount of media coverage, whereas the success stories go largely unreported – reducing confidence in infrastructure investment. The Infrastructure Partnerships Australia website includes a number of case studies which demonstrate that there are many successful projects, including the Hills M2 motorway (\$369 million), the Victorian College of Pharmacy (\$60 million) and the Wyuna Water project (\$182 million) – greater focus on these successful investments would help improve the reputation of infrastructure investing.*

*The establishment of Infrastructure Australia is focused on helping investors to understand Australia's infrastructure pipeline, albeit there is not yet evidence of implementation of the pipeline. This is another important step in helping superannuation funds to have confidence to invest in infrastructure.*

# Tax reform

**Australia's tax system continues to present challenges to the wealth management industry. 71% of respondents consider the current tax system impedes growth due to a combination of complexity and uncertainty.**

## Complexity of the tax system

The issues of complexity and uncertainty arise not only from frequent changes to superannuation and its interaction with government benefits, but also from the following:

1. Delays in introducing the replacement foreign income anti-deferral "FAF" rules
2. The present tax regime for trusts and the transition to the proposed new tax regime for managed investment trusts
3. Some draconian enforcement measures, particularly the penalty tax levied in the event of a breach of the contribution caps.

Some of the consequences of the current system identified by CEOs were:

1. Complexity and uncertainty which reduce domestic savings – with one CEO commenting that confusion leads to inaction by investors and the industry
2. Decreases global competitiveness and foreign investment
3. Investors have greater incentive to invest in property, thereby contributing to high property prices
4. Some of the larger wealth managers also cited tax impediments associated with product rationalisation, leaving investors in expensive legacy products.

68% of respondents consider the costs of managing tax affairs is significant either for the funds they manage or for their own organisation.

## CEOs' ideas for tax reform

The industry had numerous ideas of areas of tax reform to support growth including:

1. Simplifying existing tax legislation – one CEO suggested scrapping the existing tax legislation and starting again
2. Introducing tax deductibility of advice – many CEOs highlighted the importance of this reform
3. Improving the competitiveness of tax outcomes for foreign funds and investors and Australian intermediaries, and further develop the Asia Region Funds Passport
4. Increasing the superannuation contribution caps
5. Removing negative gearing
6. Aligning the top marginal tax rate with the company tax rate
7. Providing additional national incentives for investment/savings, especially addressing longevity risk, for example, greater incentives for annuities over lump sums
8. Restructure superannuation tax, to pay on the way out only, rather than on the way in.

***"Taxation is a barrier to entry for investment of all kinds."***

## **PwC insight**

*The key drivers in tax reform are simplification of the tax regime, removal of uncertainty and providing appropriate incentives, in order to increase Australia's global competitiveness and attract foreign investment. From a policy perspective the Government has announced a number of key initiatives to support these outcomes.*

*Some recent changes have already been implemented such as the reduction in withholding tax rates for distributions to non-residents by managed investment trusts, repeal of the FIF rules, reforms to realise the opportunities in Asia as well as announcements for the introduction of the Managed Investments Trust Regime.*

*The immediate challenge is to ensure that these initiatives can be efficiently implemented and without undue emphasis on integrity measures. Such measures invariably introduce complexity and detract from the attractiveness and overall success of incentives and reforms.*



***The existing and proposed tax reforms are likely to mean that no further significant tax concessions should be expected by the industry. The tax system is enormously complex and any further reform needs to consider the overall policy objectives and will only be successful if there is the political will to achieve it.***

# The most admired organisations

*In last year's survey the most admired organisations were those who were renowned for innovation, growth and performance – this year, brand strength and stability came through as important.*



*Which organisations in the industry do you most admire, and why?*

1

*Schroders – for its product performance and brand strength*

2

*CBA/CFS – for its stability and leadership during the GFC and its innovative use of technology*

3

*Platinum – because of its clear proposition and unwavering focus on quality and performance*

*Which organisations do you think do the most for promoting trust and confidence, and why?*

1

*MLC – stood its ground on commissions and has a strong business model*

2

*AMP – is sending the right message to members about the importance of savings and that it is a long term investment*

3

*Australian Super – focussed on achieving the right outcomes for its members*

# About the survey

## ***The Financial Services Council/PwC CEO Survey 2011 was conducted from May to July 2011.***

*Respondents were from a wide range of organisations covering all parts of the value chain. 31 CEOs took part in the survey, including the nation's top 10 wealth managers, representing approximately 80% of total funds under administration.*

*A key part of the survey process was to hold one-on-one interviews and roundtable meetings in Sydney and Melbourne with a range of CEOs following the initial aggregation of the survey results.*

*This report provides an overview of the survey findings, together with analysis and interpretation of the results. We have also included some direct quotes*

*from the CEOs throughout the report. These quotes reflect individual views and demonstrate the passion and/or breadth of CEOs' views and are not necessarily consistent with the overall survey findings.*



***We thank  
the CEOs for  
their time  
and insight.***

This survey is based on data collected from members of the Financial Services Council and published information from other parties including Infrastructure Partnerships Australia, Rice Warner Actuaries and various government websites. PricewaterhouseCoopers has not independently verified the information provided by survey recipients and makes no representation or warranty in relation to the accuracy or completeness of the data collected. Commentary, information or material contained in this publication is of a general nature only and is not intended to provide comprehensive advice or analysis in relation to the subject matter. This publication is not intended to be financial product advice. This publication does not constitute the provision of legal, accounting or professional advisory services and is not a substitute for specific professional advice. No person should undertake or refrain from any action based on the information in this publication without seeking advice from an appropriately qualified professional.

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# Contacts

*For further information about the survey, please contact:*

**Andrew Wilson**

*Wealth Management Industry Leader*

Phone: +61 2 8266 3337  
a.wilson@au.pwc.com

**Hugh Harley**

*Financial Services Industry Leader*

Phone: +61 2 8266 5746  
hugh.harley@au.pwc.com

**Ken Woo**

*Partner*

Phone: +61 2 8266 2948  
ken.woo@au.pwc.com

**Anthony James**

*Principal*

Phone: +61 2 8266 1205  
anthony.james@au.pwc.com

**Genesee Rock**

*Director*

Phone: +61 2 8266 8102  
genesee.rock@au.pwc.com

**Klynton Hankin**

*Director*

Phone: +61 2 8266 0028  
klynton.hankin@au.pwc.com

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*To find out more about the Financial Services Council, please visit [www.fsc.org.au](http://www.fsc.org.au) or contact one of the following:*

**John Brogden**

*Chief Executive Officer*

Phone: +61 2 9299 3022

**Martin Codina**

*Director of Policy*

Phone: +61 2 8235 2523

**Sara Rich**

*Finance Media Advisor*

Phone: +61 2 8235 2520

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*To request additional copies please contact:*

**Michelle Oliver**

Phone: +61 2 8266 1133  
michelle.oliver@au.pwc.com

*Media enquiries:*

**TJ Yen**

Phone: +61 2 8266 4642  
tj.yen@au.pwc.com



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