The Hon Josh Frydenberg MP
Assistant Treasurer
Federal Member for Kooyong

SPEECH

THE GOVERNMENT'S PRIORITIES FOR THE FINANCIAL SERVICES SECTOR

FINANCIAL SERVICES COUNCIL ANNUAL CONFERENCE
GOLD COAST

7 AUGUST 2015

CHECK AGAINST DELIVERY

Introductory remarks and acknowledgements

Good morning everyone, it's great to be with you again.

I'd firstly like to congratulate the Financial Services Council (FSC) on what has, by all reports, been an outstanding conference so far.

It has been characterised by an enthusiastic exchange of ideas, which is how true innovation emerges — the type that will help to shape the financial services industry in the years ahead.

Under Sally Loane's leadership, the FSC continues to provide a strong voice for the financial services industry.

The importance of Australia's financial services sector cannot be understated. You have heard me say it before and I will continue to say it going forward.

The Coalition, like the FSC, sees the enormous potential financial services present for Australia. In 2013-2014, the financial and insurance services industries contributed around $130 billion to our economy, roughly eight per cent of total GDP. The sector also employs around 400,000 workers.

This contribution to our economy makes financial services one of Australia's largest sectors.

But outside of this, the sector plays another very important role; taking on the responsibility of both protecting and growing the savings and livelihoods of Australians. With Australia's superannuation system projected to grow from $2 trillion today to an estimated $9 trillion by 2040, the importance of this role to the financial security of all Australians is clear.

This presents an enormous opportunity for the industry but quite rightly, it also creates a very high public expectation that the sector will perform this privileged role in the best interests of all Australians.

It is for this reason that the Government's financial services reform agenda focuses heavily on building greater trust in the industry while also providing opportunities for the industry to reach its full potential – both domestically and internationally.

Today I want to discuss the Government's ongoing reform priorities for the financial services sector while also providing an update on progress which has been made since I spoke to you in April this year. In particular, I'd like to discuss four Government priorities for the financial services sector: superannuation; lifting professional standards; life insurance; and the key outstanding recommendations from the Johnson Report.

A productive time

The first eight months of this year have been very productive for the Government, particularly in pursuing our priorities for the financial services sector. I'd like to take a moment to share some of this progress with you.

Financial System Inquiry

Upon being appointed Assistant Treasurer, I took the opportunity to consult with industry and consumer groups on their thoughts on priorities for the sector, and particularly the Financial System Inquiry (FSI) recommendations. This was an engaging process, which showed the enthusiasm and consensus that the sector holds for improving the industry.

As you know, the Government is now considering the views of all stakeholders before responding to the FSI, which we expect to do shortly. As we move towards the implementation phase of the FSI, I want to assure you that we will continue to work closely with all stakeholders to ensure the reforms that flow are considered and effectively implemented.

The Register of Financial Advisers

In March, the Government launched an industry-wide register of financial advisers.

The register now boasts more than 23,000 advisers and will help boost transparency and accountability across the sector. In fact, since its launch in March, there have been over 233,000 searches of advisers undertaken; showing the enormous potential the register has in providing the public with valuable information on those who manage their finances.

We are also considering possible enhancements to the register and continue to seek feedback from all stakeholders on how the register can be improved.

Future of Financial Advice (FOFA) refinements

In June, I announced that the Government had agreed with the Opposition to progress minor and technical refinements to the Future of Financial Advice (FOFA) laws.

The agreed refinements will improve the operation of FOFA and alleviate a number of unintended consequences, most of which have arisen since the laws were legislated.

These refinements included making FOFA consistent with other parts of the Corporations Act, for example aligning definitions of wholesale and retail.

As I have said before, FOFA should now be considered settled and given time to work.

Investment Manager Regime

Also in June, legislation passed through the Parliament to finalise a new tax regime to clarify the rules around the tax treatment of foreign investors who use an Australian based fund manager. This uncertainty deterred foreign investors from using Australian fund managers, in relation to investing in both Australian and overseas assets.

Currently, only just over three per cent of funds under management in Australia come from foreign investors. If Australia is to compete with the likes of Singapore, Hong Kong and the United Kingdom, where such rates of foreign funds are 80 per cent, 70 per cent and 40 per cent respectively, such changes are vital.

Capability review of Australian Securities and Investments Commission

In the last couple of weeks, I have also announced that the Government has commissioned a review to consider the capabilities of the Australian Securities and Investments Commission (ASIC). The review will be chaired by Commissioner of the Productivity Commission, Karen Chester.

ASIC plays an important role in ensuring that investors and consumers have confidence in Australia's financial system. This review will ensure that ASIC has the appropriate governance, capabilities and systems in place to meet these objectives and future regulatory challenges.

Importantly, in undertaking the review, the expert panel will consult extensively with the private sector, industry bodies and regional and consumer representatives to ensure all views are considered.

Ongoing priorities

While I am proud of what the Coalition Government has been able to achieve to date, we remain committed to further reform to make the financial services sector better for both industry and consumers.

Superannuation

I'd now like to talk about the first of our key financial services reform priorities - superannuation.

Superannuation reform is something that, with good reason, the FSC has a great interest in. Likewise, the Government wants to ensure that superannuation provides the best possible outcomes for Australians saving for their retirement.

With this in mind, the Government is focused on reform in several key areas.

i) Governance

When I spoke to you in April, I mentioned the need to get regulatory settings for superannuation right, including governance arrangements.

In June the Government released exposure draft legislation which proposes that all APRA-regulated superannuation funds — including corporate, industry, public sector and retail funds — have trustee boards with at least one-third independent directors and an independent chair.

The Government is committed to ensuring that the retirement savings of Australians are managed with the highest standards of governance, in line with best practice. In fact, APRA already requires that the boards of banking and insurance entities have a majority of independent directors. ASX corporate governance principles also recommend the board of a listed entity have a majority of independent directors, including an independent chair.

The proposed measures will modernise board requirements to help ensure that directors with the best experience and expertise are represented on superannuation trustee boards; enhancing decision making and producing better outcomes for fund members.

The proposal is not about any single sector. It is about improving governance across all APRA-regulated funds.

When these proposals were announced, the feedback was overwhelmingly positive, in addition to the FSC support has come from groups such as CHOICE, National Seniors Australia, the Association of Superannuation Funds of Australia, the Australian Chamber of Commerce and Industry, the Australian Institute of Company Directors, the Business Council of Australia, Chartered Accountants, COSBOA and the Governance Institute, just to name a few.

I've also been pleased with the broad-based support from both industry and retail funds, and I welcome the constructive positions of funds including among others BT Financial Group, First State Super, LG Super, Mercer, Suncorp, UniSuper and VicSuper.

To put my political hat on for a second, and with the above support in mind, I was disappointed to hear the Leader of the Opposition denounce these proposals as 'interfering' with the superannuation system.

This couldn't be further from the truth.

In fact, the proposals are in line with recent independent reviews of the superannuation system that recommended a higher number of independent directors for superannuation trustee boards. These reviews include the recent FSI and the 2010 Cooper Review, commissioned by the previous Labor Government. In fact, the Cooper Review specifically recommended that 'no less than one-third of the total number of member representative trustee-directors must be non-associated and no less than one-third of employer representative trustee-directors must be non-associated.'

Yet, this was a point which Mr Shorten, in responding to the Cooper Review as then Assistant Treasurer and Minister for Financial Services and Superannuation, chose to ignore.

Again, I reiterate. These proposals are about strengthening the governance of all APRA-regulated funds.

With the submission period now closed, I'd like to thank everyone who put their views forward, as we now consider the feedback received.

Before I move on, I'd like to reflect on a few of the claims that have been made during the consultation process.

Firstly, it has been suggested that the Government wants to end equal representation on trustee boards. This is not the case.

The Government is in no way preventing trustees from enshrining equal representation in their constitutions. The draft legislation does not refer to the composition of the remaining two-thirds of board members; leaving capacity for boards to split these directors between member and employer representatives; if they consider this to be appropriate.

The proposals will allow trustees to look at the composition of their boards and to structure them in the manner they believe will best serve their members' interests.

Further, concerns have also been raised about quantifying the compliance costs of the proposals, with suggestions that the Government has not complied with its own best practice regulation requirements.

Once again, this is not the case. As the former Parliamentary Secretary to the Prime Minister with responsibility for deregulation, I place great importance on these matters. A fully compliant Regulatory Impact Statement, or 'RIS', detailing the expected costs and benefits of this proposal will be included with the final legislative package.

In putting forward these proposals, the regulatory burden on industry was firmly on the Government's mind, while at the same time focusing on the best outcome for fund members. Our reforms have sought to minimise compliance costs by only requiring one-third independent directors, rather than a majority as recommended by the FSI. A three year transition period will also apply and we have given boards the flexibility to decide whether they will appoint additional directors or simply reduce the size of their board to meet the new requirements.

Lastly, I want to respond to the claim that there are an insufficient number of candidates to fill these positions.

There are currently around 1000 directors in the super industry. If one third of those have to be independent, there will be a maximum of 330 independent directors required across the whole industry, noting that many funds, including industry and public sector funds, already have a number of independent directors on their boards.

The Australian Institute of Company Directors (AICD) alone already has 11,000 members on their database who are actively looking for directorships.

Adding to this, a number of superannuation industry bodies have also started to train independent directors and expect several hundred to go through their programs.

It is simply not the case that there is a shortage of candidates to fill these positions.

Our key objective is to have the best people governing the retirement savings of Australians, and I'm confident these reforms will do just that.

ii) Transparency

The Government is also focused on creating a more informed superannuation market, delivering increased value to consumers by enhancing the quality and transparency of information available.

That's why we sought feedback in our superannuation discussion paper on two measures to improve the transparency of fund performance; namely, portfolio holdings disclosure and choice product dashboards.

The Government has listened to industry concerns about the significant regulatory cost involved in implementing these two measures. We are now working on finalising exposure draft legislation on a revised portfolio holdings disclosure model and choice product dashboard regime, for public consultation which I hope to commence in coming weeks.

Our aim will be to strike the right balance between minimising the compliance burden on superannuation funds, and enhancing transparency and comparability of information for consumers so they can make informed decisions and drive greater competition and accountability in the superannuation sector.

iii) Competition

One of the most significant reform opportunities in superannuation remains the process by which default funds are selected.

The FSI found that superannuation fees have not fallen by as much as would be expected; given the substantial increase in size and scale within the system. The Inquiry cited data showing that between 2004 and 2013, average fees only fell by 20 basis points whereas the size of the average fund increased by more than twelvefold over the same period.

The Government is committed to increasing competition in the default superannuation market. Competitive forces are as fundamental to the economy as they are in the superannuation industry. Competition remains the most effective way to put downward pressure on fees, increase the quality of products, drive greater efficiency and better services for members.

Importantly, MySuper has provided a strong regulatory platform for funds to compete. As you know, MySuper products were designed to be simple, cost-effective default products, helping ensure that members of default superannuation funds do not pay for product features they do not need or use. They were also designed to be transparent and comparable, encouraging greater competition to help put downward pressure on fees.

MySuper has been a strong step in the right direction. However, without true competition, MySuper will never achieve its full potential.

Opening the superannuation market to competition will require consideration of an alternative to the current, poorly-conceived Fair Work Commission process for the selection of default funds in modern awards. This is a process which, just last year, the Federal Court described elements of as 'confusing to say the least'.

In considering what, if anything should be put in its place, the Government will first and foremost seek to make sure that all MySuper products are of the highest quality – not just those which are offered under Awards.

We will also ensure that the wider regulatory framework is robust and appropriate to support moving to an open and competitive market. This will include carefully examining whether existing protections against funds or related parties offering inducements or inappropriately influencing an employer's choice of fund through the threat of industrial disputation are sufficient.

Ultimately, my objective will be to put in place a framework that will generate the strongest possible competitive forces for the benefit of every superannuation fund member.

Given the significance of reform in this area, I will continue to consult with a wide range of stakeholders, APRA and other government agencies to ensure this outcome is achieved.

iv) Retirement incomes

I want to touch briefly on another of the strong themes in the FSI: the need for everyone to increase our focus on the pension phase in which superannuants draw-down their savings to fund retirement income.

As the system matures, we need to make sure we are helping Australians achieve higher and more stable retirement incomes.

This will require innovation on the part of industry to develop solutions to meet the needs of consumers, signs of which are already occurring.

It will also likely require new thinking on the part of government and regulators.

The FSI recommended that trustees facilitate the provision to retirees of 'Comprehensive Income Products for Retirement'. This would require changes to the rules that currently discourage financial products which can help manage longevity risk and improve overall retirement income.

As I outlined recently in a speech to the Committee on Sustainable Retirement Incomes, the Government has been reviewing these rules over the past year.

Many of you here today will have been involved in this process, and I want to thank you for your continuing contributions.

I am confident that the Government's response to the FSI will set off a wave of product innovation in this area that will benefit consumers. Together with other retirement income changes, the Government will be looking to industry to help develop the next generation of retirement products. This task will become increasingly important with the number of Australians aged 65 and over projected to more than double by 2054-55 compared with today.

<u>Professional standards</u>

Our second financial services reform priority relates to increasing the professional, educational and ethical standards in the financial advice industry.

Many of you have raised concerns about the current arrangements noting that they are no longer appropriate. This has been evident in my consultations with industry, within the FSI, and of course within the bipartisan Parliamentary Joint Committee inquiry into proposals to lift the professional, ethical and education standards in the financial services industry.

Roy Morgan also reported in its 2014 State of the Nation report that only 25 per cent of Australians rate financial planners' standards of ethics and honesty as 'very high' or 'high'.[1]

It is clear that reform is needed if we are to boost public confidence. This can be achieved through an enduring framework that raises the professional, ethical and educational standards of advisers.

In the last few months, more than 50 submissions have been received in response to the Government's consultation paper on this issue.

We are close to finalising our approach in this area and remain very focused on achieving a broad consensus, and bipartisan support in the Parliament.

I will have more to say about this following the Government's response to the FSI.

Life insurance

The third financial services reform priority area is life insurance.

This sector is, of course, vital for our community. Life insurance products provide financial security at times of need with over $7 billion in claims paid out in 2014[2], an incredible $19 million every day.

Yet research undertaken by KPMG has shown that many Australians do not have adequate insurance coverage to protect themselves and their families.[3]

Underinsurance not only leaves Australian families exposed to economic risk, but it also places significant pressure on the Government and taxpayers.

---

[1] 'Do finance professionals need an image overhaul?' (1 April 2014), Roy Morgan Research, available at: www.roymorgan.com.
[2] *Quarterly Life Insurance Performance*, APRA, March 2015 (issued 19 May 2015).
[3] *Underinsurance: Disability Protection Gap in Australia*, KPMG, February 2014; *Underinsurance: Death Protection Gap in Australia*, KPMG March 2014. Both reports available at www.fsc.org.au .

At the same time, practices in the industry have been under scrutiny following ASIC's finding last year that 37 per cent of consumers received advice that was not compliant with the law.

Further, ASIC found conflicts of interest have had a detrimental impact on the quality of advice consumers are receiving.

With three prior independent and government reports recommending reform in this area, it was clear that it was time to improve consumer outcomes and remove incentives for inappropriate policy replacement.

Earlier this year I noted that the status quo was no longer sustainable and called on industry to take the lead on reform before the Government was forced to.

In response to this call, I have been very pleased with how industry has productively worked together to develop genuine solutions.

In June, this culminated in the Association of Financial Advisers, the Financial Planning Association of Australia and the Financial Services Council putting forward a reform package to the Government on behalf of the retail life insurance industry.

The package includes changes to upfront commissions, measures to reduce inappropriate policy replacement, and elements to enhance the quality of advice and improve industry efficiency.

As with all compromises, neither side got everything they wanted, but by coming to the table, each side was able to obtain a better outcome for their members than they would have in isolation.

The Government is considering industry's proposals as part of our response to the FSI. Of course, implementing the proposals will require ongoing cooperation. Industry, along with the Government, continues to flesh-out the detail of this package and while there is considerable detail to be finalised, the Government will not lose sight of the end objective; better outcomes for consumers.

This objective includes an expectation that where substantial savings are generated from the reforms, these would be passed-on to the consumer. We are currently exploring additional mechanisms to support this principle.

As I indicated in my announcement welcoming industry's agreement, after three years the Government would conduct a review to test the effectiveness of the measures. Neither consumers nor the industry can afford to see a repeat of the outcomes in ASIC's report.

I am very conscious of the challenges posed by industry reform of this scale, particularly as a result of the many discussions I've had with advisers since being appointed Assistant Treasurer. If there is a message I can provide the life insurers in this room, it is that advisers are looking to you to help them transition and navigate these significant reforms.

Making sure all parts of the industry thrive as a result of these reforms should be seen as a shared goal and given the level of underinsurance in Australia; Australians need the industry to come together to improve the quality of advice and to ensure it remains accessible to those that need it most.

Again, I will have more to say on the role the Government will play in this process following our response to the FSI.

Johnson Report

I turn now to the final financial services priority that I would like to cover with you today: the Government's continuing plans to make Australia a leading financial centre in our region.

In June I had the pleasure of travelling to Japan and Korea with Sally and other industry representatives to promote Australia's financial services strengths and capabilities.

This trip reinforced the optimism I hold for the enormous opportunities that lie in our region. Such opportunities are highlighted by the burgeoning Asian middle class, set to reach more than three billion people by 2030. The region is already home to 60 per cent of the world's population and by 2019 it is expected to account for 42 per cent of global economic output.

The financial services sector has great potential to benefit from this extraordinary growth, as it currently represents less than six per cent of Australia's total services exports.

The challenge for each of us is to make sure we're in the best position to take advantage of these opportunities.

In 2009, led by Mark Johnson AO, the Australian Financial Centre Forum published the Johnson Report, which outlined how the Australian financial services industry can export its expertise and improve competition.

It's been a long road but I am pleased to say we are making strong progress and we are determined to do everything we can to advance the remaining key recommendations in the report.

On the issue of Managed Investment Trusts, shortly the Government will introduce legislation to modernise the tax system for these trusts and improve the international competitiveness of Australian managed funds.

As announced in the Budget, managed funds can opt-in to the new rules from 1 July this year, if they are ready to apply the new rules earlier.

On the matter of Collective Investment Vehicles, or CIVs, the Government is considering the design features of a possible new range of tax flow-through CIVs that could be offered by Australian fund managers.

As you know too well, Australia's funds management sector, one of the largest and most sophisticated in the world with $2.6 trillion of total funds under management, manages only 3.5 per cent of those funds on behalf of non-resident investors.

In 2014, the FSC commissioned Deloitte to report on the possible economic impact of increasing Australian funds management exports. The report found that if foreign funds under management in Australia were increased so that funds management exports were doubled, this could result in additional GDP of $330 million.

A wider range of CIVs will assist the export of financial services by making Australian products more attractive to non-resident investors, particularly those in the Asia-Pacific region.

As noted earlier, the Investment Manager Regime, or 'IMR', a key recommendation of the Johnson Report, passed through Parliament in June.

Taking note of advice from industry, we took the IMR back to the drawing board and redesigned it to reflect international best practice.

Passage of this measure was met with overwhelming positive feedback from industry. I am confident that the IMR we have put in place will encourage greater foreign investment as it was always intended to do.

My recent trip to Japan and Korea also allowed me to further progress the Asia Region Funds Passport.

While there, I held critical meetings with key government and business representatives, including Japan's State Minister for Finance and the Chair of the Korean Financial Services Commission.

The Passport will assist Australian fund managers to offer their world-class services across the region.

It will create a regional market for managed funds by reducing regulatory barriers and creating a standard set of rules. This will mean that a fund registered domestically can be offered in other participating countries without needing to meet different operational and licensing requirements; giving fund managers the opportunity to boost their presence in Asia and giving investors more choice.

The Government wants to ensure the Passport becomes the de-facto regional standard. This will require both a world-class framework and broad participation by countries in the region.

This underscores the reason for my trip to Japan. Japan is not currently a signatory to the Passport but its inclusion would be a huge step towards a truly regional framework, and one that Australia would wholeheartedly support. Not only is Japan the world's third largest economy, they also have more than $4 trillion of funds under management, and an aging population that will require the very types of financial services offered under the Passport.

Once the Passport has commenced we should look to expand membership further, to include regional economies that are not APEC member states, such as India.

Australia has led development of the Passport, working with our partners to implement what is a ground-breaking initiative for the region.

Once the Government has done its part, it will be over to you to take advantage of the opportunities we have created.

I look forward to reading about your successful exploits in the near future!

Conclusion

I would like to finish by thanking the FSC for inviting me here today to be part of this conference.

It is always a pleasure to be able to speak with so many industry leaders and to keep you informed of the Government's priorities.

As I said earlier, the Government strongly believes in this sector and knows that it has enormous potential.

We share your enthusiasm and look forward to working with you to raise standards, improve confidence and deliver better consumer outcomes.

I encourage you to stay tuned for the Government's forthcoming response to the FSI. You can be confident that this will help to make sure this industry continues to thrive and compete while also giving Australians the confidence to save, invest and protect their financial interests.

This, as you would all agree, will be a great outcome for all of us.

Thank you.

Ends