FINANCIAL SERVICES COUNCIL

2015

RESPONSE TO THE FINANCIAL SYSTEM INQUIRY

31 March 2015

Senior Adviser

Financial System and Services Division

The Treasury

Langton Crescent

PARKES ACT 2600

By Email: fsi@treasury.gov.au

Dear Mr Crawford

Response to Government's final report of the Financial System Inquiry

The Financial Services Council (FSC) welcomes the opportunity to make submissions in relation to the final report of the Financial System Inquiry.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees.

The Council has over 120 members who are responsible for investing more than $2.5 trillion on behalf of 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world.

The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Please contact me on (02) 9299 3022 to discuss this submission.

Yours sincerely

ANDREW BRAGG

Director of Policy & Global Markets

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SUMMARY OF FSC RECOMMENDATIONS:

ADVICE

RECOMMENDATION:

The FSC supports raising levels of professionalism and enhancing ASIC's power to ban individuals from managing financial services organisations.

RECOMMENDATION:

The FSC supports the enhanced register of advisers, as well as increasing minimum education requirements for those who provide personal advice to retail clients on Tier 1 products/or 'relevant financial products'.

RECOMMENDATION:

The FSC supports relabelling 'general advice' with 'general information' and supports disclosure of licensee ownership of the financial advice register.

RECOMMENDATION:

The FSC recommends replacing 'general advice' with 'general information'.

RECOMMENDATION:

The FSC recommends that consideration be given to 'general advice' remaining a subset of 'financial product advice' or relabel 'financial product advice' to remove the word advice, to ensure that someone providing 'general advice' or 'general information' cannot hold themselves out as providing advice in the form of 'financial product advice'.

RECOMMENDATION:

The FSC is not supportive of replacing 'personal advice' with 'financial advice' on the basis that 'personal advice' better reflects the nature of the advice provided.

RECOMMENDATION:

The FSC is supportive of limiting the provision of 'personal advice' to someone who provides personal advice to retail clients on Tier 1 product or 'relevant financial products' and who has met the minimum education and competency requirements set out on page 22-25 and Table 1 of this submission.

RECOMMENDATION:

The FSC is supportive of restricting the terms 'financial adviser' and 'financial planner' to those who:

- provide personal advice to retail clients on tier 1 products/relevant financial products;
- are included on the new financial adviser register; and
- meet the minimum education and competency requirements set out on page 22-25 and Table 1 of this submission.

RECOMMENDATION:

Subject to the FSC's feedback provided in response to the PJC's recommendation 5, the FSC is supportive of many aspects contained within this recommendation.

Specifically, the FSC is supportive of:

- the enhanced adviser register and a unique identifier which follows an adviser throughout their career (even where they have a break and re-join the industry);
- a new adviser being added to the register when the new adviser has met the minimum education and competency requirements set out on page 22-25 and Table 1 (noting that advisers will be added to the register once they pass the registration exam, even where this takes place during the professional year);
- the inclusion of higher qualifications awarded by a professional body;
- the inclusion of information about any bans, disqualifications or enforceable undertakings by ASIC, as well as recommending targeted consultation on including material censures or limitations imposed by AFSLs, Professional Bodies on the adviser register to ensure further disclosure is meaningful to consumers; and
- the register noting that an adviser is no longer authorised to provide personal advice if their membership of their nominated professional body is suspended or revoked.

RECOMMENDATION:

The FSC is supportive of organisational licensee fees reflecting the scale of the advice organisation subject to broader industry consultation on fees.

RECOMMENDATION:

The FSC is supportive of increasing the mandatory education requirements as outlined in Table 1: Education and Competency Requirements and for an independent body to establish the initial and ongoing education and competency requirements.

RECOMMENDATION:

The FSC is supportive of ASIC listing advisers on the register when they have met the minimum education and competency requirements in Table 1 as confirmed by the nominated Professional Association.

RECOMMENDATION:

The FSC is supportive of ongoing professional development being set by their professional association, with the Independent Body facilitating cross industry standardisation. The CPD framework should encompass core CPD requirements for all to complete and cater for specialisations (such as SMSF or risk insurance advice).

RECOMMENDATION:

To ensure appropriate funding, the FSC is supportive of an independent body being funded by an ASIC industry levy with Ministerial appointees. It is recommended that the Board be comprised of:

- representatives from ASIC and the TPB;
- education providers with knowledge of financial advice;
- experienced individuals from the industry/advisers; and
- independent chair such as an academic.

To support input from key stakeholders the FSC also recommends that stakeholders have direct involvement with the Independent Body via a variety of sub-committees which include:

- professional associations;
- consumer representation; and
- licensees (given regulatory responsibilities imposed on licensees for adviser competency it is important for licensees to be able to provide input).

RECOMMENDATION:

The FSC supports Professional Associations establishing Codes of Ethics which meet Professional Standards Council (PSC) requirements. Codes of Ethics should be approved independently of any application for recognition as a Professional Association.

RECOMMENDATION:

The FSC is supportive of Professional Associations establishing Professional Standards Schemes. The PSC should provide timing guidance on when the Professional Standards Scheme can be up and running.

Given the regulatory and licensing framework, the FSC also believes it is critical that licensees and relevant stakeholders can continue to make recommendations to ASIC and the independent body about the registration of Advisers. As such we do not support the restriction that only Professional Associations can provide recommendations to ASIC and the independent body.

RECOMMENDATION:

The FSC is supportive of advisers being members of a professional association and those associations being recognised by the Professional Standards Council.

In relation to education and registration requirements the FSC is supportive of advisers meeting the education and competency requirements as set out in Table 1 of this submission.

RECOMMENDATION:

The FSC would like to see the new advice framework implemented promptly and efficiently, however recognises that implementation of the many recommendations will require time and proposes that the timeframes be linked to the establishment of the new Independent Body as set out in Table 2, including appropriate transitional arrangements for existing and transitioning advisers as set out in Table 1 of the submission.

FUNDS MANAGEMENT AND INVESTMENT

RECOMMENDATION:

FSC recommends that the FSI’s analysis on the funds management sector in Australia should not be used in any future policy decisions by the Government. It is important that any policies affecting competition and fees in the system are based on accurate data so as not to create adverse outcomes.

RECOMMENDATION:

Cooperation of the various regulatory agencies should be legislated and international competitiveness issues included in their mandates. An ASIC commissioner should be appointed to specifically deal with international trade issues.

RECOMMENDATION:

ASIC should ensure market access is available for all existing FTAs with mutual recognition between regulators.

RECOMMENDATION:

The regulatory process better considers international competitiveness and the outstanding recommendations from the Johnson Review 2009 are implemented as a matter of priority.

RECOMMENDATION:

A comprehensive review of the regulation of managed investments is not warranted. We do not support the need for a holistic review of managed investments regulation.

RECOMMENDATION:

If the Government considers it appropriate to review the illiquid fund provisions, the Government should extensively consult on any potential changes. This should include weighing up costs and benefits and carefully considering whether or not changes are necessary and appropriate, and if so, the impacts of any changes on new and existing funds.

RECOMMENDATION:

Support the removal of market ownership restrictions from the Corporations Act 2001.

RECOMMENDATION:

FSC supports development of a feasibility study and strategy for impact investing but does not support mandating investments or education standards.

RECOMMENDATION:

The Government should remove the current impediments to corporates issuing bonds. If disclosure is seen as the largest impediment, costs and benefits should be carefully considered before a change to requirements.

LIFE INSURANCE

RECOMMENDATION:

The FSC strongly supports the recommendation that the Productivity Commission commences an inquiry into the benefits of improved data sharing. The FSC is confident that privacy and security concerns can be carefully managed so as to allow the Government and private sector to access a valuable, untapped resource.

RECOMMENDATION:

The FSC submits that the Parliament continue its support for the independent process, led by independent Chairman John Trowbridge, which has recently concluded.

RECOMMENDATION:

The FSC supports the recommendation that bank accounts and life insurance policies should be classified as unclaimed monies only if they are inactive for seven years. In addition, the FSC submits that the current arrangements in relation to the unclaimed life insurance money provisions create unnecessary complexity, are inefficient and do not achieve the stated objective of balancing the protection of the value of the account holder’s funds with effectively reuniting account holders with their money.

RECOMMENDATION:

The FSC proposes a common rationalisation regime that can be applied to the following product types or structures:

- life insurance products (risk and investment);
- managed investment schemes and investor directed portfolio services; and
- underlying investment structures.

The FSC’s proposed mechanism is outlined in Appendix B.

RECOMMENDATION:

The FSC believes that inefficient stamp duties applying to life insurance products contribute toward underinsurance and should be abolished. This will be a core component of the FSC's response to the Federal Government's Tax White Paper and Federation White Paper in 2015.

To the extent that changes are made to Australia's taxation system, we encourage the Commonwealth to ensure the States commit to their promise to abolish inefficient taxes. Importantly this commitment should be a focus of any agreement to make changes to the GST.

Backtracking of States on prior commitments has resulted in a patchwork of inefficient, distortionary tax outcomes. These are in turn impacting on areas of the economy with undesirable consequences.

SUPERANNUATION

RECOMMENDATION:

The FSC recommends that borrowing within APRA regulated superannuation funds not be affected by this review and that the FSI recommendation be solely confined to SMSFs, as was intended by the FSI final report.

RECOMMENDATION:

The FSC recommends that the Intergenerational Report (IGR) becomes the evidentiary basis for the measurement of the effectiveness of the superannuation system and examination of proposed reforms to the system. The natural relationship between the IGR, which examines the Government's fiscal position forty years into the future, and the superannuation system, which is intended to address the intergenerational cost of an ageing population, is clear.

RECOMMENDATION:

The FSC recommends the relationship between the IGR and measuring and reforming the superannuation system receive broader political support.

RECOMMENDATION:

The FSC recommends the Government open the default superannuation market to competition by allowing any APRA approved MySuper product to compete to become the default fund for any workplace. This requires the Government to remove superannuation from the modern award system and allow all employees covered by enterprise agreements to exercise choice of fund.

On this basis the FSC supports a review of the performance of the superannuation system in 2020 as part of the IGR process, after a period of open competition. A subsequent review, in line with that recommended in the FSI Final Report, could be conducted after 2020 should provide an evidentiary basis that demonstrates that the superannuation system is achieving its objectives.

RECOMMENDATION:

FSC supports the recommendation which would require a trustee to pre select a retirement option for their membership.

RECOMMENDATION:

The FSC supports the recommendation to allow all Australians to select a superannuation fund.

RECOMMENDATION:

FSC recommends a majority of independent directors be required on superannuation boards with a robust test of independence.

RECOMMENDATION:

The FSC submits that life company directors already face significant indemnity for making good losses. It is not appropriate that liabilities for life insurance company directors be aligned with the managed investment scheme regime.

RECOMMENDATION:

The FSC supports a shift in perception that superannuation is intended to provide retirement income. It is necessary to undertake further consultation with ASIC and the ATO to manage the regulatory implications and commercial nature of the data being used for these purposes.

REGULATORY SETTINGS

RECOMMENDATION:

The FSC recommends that the Government not introduce a new and unnecessary product design and distribution obligation given: existing multi-layered obligations on financial services providers; implementation risks associated with the proposed obligation; the significant compliance burden it would impose; and the negative impact such an obligation would have on consumer autonomy and choice.

RECOMMENDATION:

The FSC recommends that the Government not provide ASIC with a product intervention power given ASIC already has wide-ranging powers which allow it to act where there have been breaches of the law or license conditions. The introduction of a new discretionary power would see ASIC stray into the field of mandating permissible products, a role which is properly the responsibility of the legislature. If introduced, the FSC recommends that the power only be exercised as a last resort, be constrained through robust accountability and oversight mechanisms, and that clear guidance be provided regarding the circumstances in which ASIC might exercise the discretion.

RECOMMENDATION:

The FSC recommends that the Government implement Recommendations 23 and 39, in close cooperation with the financial services industry.

RECOMMENDATION:

The FSC recommends that a Financial Regulator Assessment Board be created - with a clear mandate – which would provide independent oversight of key regulators.

RECOMMENDATION:

The FSC recommends that: ASIC move to a three year funding model, with industry providing funding on a cost recovery basis; that ASIC staff be excluded from the *Public Service Act 1999* in order to retain and attract highly skilled staff; and that capability reviews of ASIC take place on a six-yearly cycle. The FSC supports ASIC being provided with the powers necessary to carry out its mandate, but has serious concerns regarding the introduction of a new product intervention power and the ability for ASIC to block material changes in ownership/control of financial services licensees.

RECOMMENDATION:

The FSC recommends that there be a greater focus on competition within the financial services sector, including periodic sectoral reviews, and that the Government better facilitate financial services trade.

RECOMMENDATION:

The FSC recommends that the Government implement Recommendation 31, so as to ensure that compliance costs are minimised and that reforms operate as intended.

RECOMMENDATION:

The FSC recommends that the Government introduce an Alternative Australian Trusts Act which would support financial integration, especially in the Asia Pacific region, and provide new, fit for purpose, legal infrastructure for Australian trusts.

CHAPTER 1: FINANCIAL ADVICE

This Chapter is divided into two sections. The first section responds to the Financial System Inquiry (FSI) recommendations relating to financial advice. Raising standards for financial advice is also considered by the Parliamentary Joint Committee on Corporations and Financial Services (PJC) report into proposals to lift the professional ethical and education standards in the financial services industry (PJC Inquiry). The second section responds to the PJC recommendations.

Section A: FSI Recommendations

The Financial System Inquiry Final Report made three recommendations in relation to financial advice. The FSC's response to those is as follows.

FSI RECOMMENDATION 24:

Industry raising standards of conduct and levels of professionalism and enhancing the power to ban individuals from management.

The FSC supports raising professionalism and enhancing ASIC's power to ban individuals from managing financial services organisations. Further feedback on raising adviser standards of conduct and professionalism are addressed in our response to the PJC recommendations in section B of chapter 1.

RECOMMENDATION: The FSC supports raising levels of professionalism and enhancing ASIC's power to ban individuals from managing financial services organisations.

FSI RECOMMENDATION 25:

Raising the competency of financial advice providers and introducing an enhanced register of advisers. The report envisages that the minimum standards for advisers recommending Tier 1 products should include a relevant tertiary degree, competency in specialised areas and ongoing professional development.

The FSC supports the enhanced register of advisers, as well as increasing minimum education requirements for those who provide personal advice to retail clients on Tier 1 products/or 'relevant financial products.'[1] The FSC's proposal to increase minimum education standards for financial advisers is set out in Table 1 of this submission.

[1] Those who provide advice on 'relevant financial products' are included on the new Financial Adviser Register. Relevant Financial Products is defined in the *Corporations Amendment (Register of Relevant Providers) Regulation 2015* which

RECOMMENDATION:

The FSC supports the enhanced register of advisers, as well as increasing minimum education requirements for those who provide personal advice to retail clients on Tier 1 products/or 'relevant financial products'.

<u>FSI RECOMMENDATION 40:</u>

<u>Rename 'general advice' and require advisers to disclose ownership structures.</u>

The FSC supports relabelling 'general advice' with 'general information'.

The FSC engaged GfK to undertake consumer testing of which term was the best descriptor of general advice; 'product sales information', 'general information' or 'general advice'.

A survey of more than 1,000 people preferences indicated that 'general information' is the best descriptor of general advice.

The FSC also supports disclosure of licensee ownership for inclusion in the adviser register.

RECOMMENDATION:

The FSC supports relabelling 'general advice' with 'general information' and supports disclosure of licensee ownership of the financial advice register.

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means financial products other than: basic banking products, general insurance products, consumer credit insurance or a combination of any of these products.

Section B: PJC Recommendations

The PJC Inquiry made fourteen recommendations in relation to financial advice. The FSC's response to those is as follows:

PJC RECOMMENDATION 1:

The committee recommends that the term 'general advice' in the Corporations Act 2001 be replaced with the term 'product sales information' to better reflect the nature of that information.

The FSC supports the Committee's recommendation to relabel general advice on the basis that it will better reflect the nature of the information provided to consumers. The FSC is supportive of replacing 'general advice' with the term 'general information'.

Recommendation 40 of the Financial System Inquiry suggested replacing 'general advice' with a consumer tested term, whereas the PJC recommended that it be replaced with the term 'product sales information'.

RECOMMENDATION: The FSC recommends replacing 'general advice' with 'general information'.

Whilst replacing 'general advice' with 'general information' will better reflect the nature of information provided to consumers we are concerned that further confusion will still remain if 'general advice' remains a subset of 'financial product advice' or relabel 'financial product advice' to remove 'advice' from the term.

There are two types of financial product advice – personal advice and general advice. If the label 'general advice' is replaced with 'general information' an individual could continue to hold themselves out as providing advice to consumers in the form of 'financial product advice'.

In our view this has the capacity to confuse consumers, even where the label 'general advice' has been altered, as the word 'advice' can still be used/associated with the provision of this type of information.

This may also lead consumers to erroneously believe the information provided has considered their personal circumstances, needs or objectives, or has been tailored as such. The FSC recommends that consideration be given to whether 'general advice' should remain a subset of 'financial product advice' or the word 'advice' being removed from 'financial product advice' to ensure that someone providing ‘general advice’ or ‘general information’ cannot hold themselves out as providing advice in the form of ‘financial product advice.’

RECOMMENDATION:

The FSC recommends that consideration be given to ‘general advice’ remaining a subset of ‘financial product advice’ or relabel ‘financial product advice’ to remove the word ‘advice’, to ensure that some one providing ‘general advice’ or ‘general information’ cannot hold themselves out as providing advice in the form of ‘financial product advice’.

PJC RECOMMENDATION 2:

The Committee has recommended that the term ‘personal advice’ be replaced with ‘financial advice’ to better reflect the nature of that advice.

Personal advice is a subset of financial product advice and whilst it includes a recommendation or opinion that is intended to influence a person in relation to a particular financial product and takes into account the person’s needs or objectives, it also covers class of financial product advice which does not involve a specific product recommendation. This includes the provision of advice on a broad range of topics such as:

- whether or not to hold insurance cover inside or outside superannuation;
- whether shares, or an alternative class of product, may be appropriate for a person; and
- strategic advice which prioritises the needs and objectives of the client which can be focused on a particular topic such as retirement planning and may not necessarily include any product recommendations.

Given the breadth of topics covered under personal advice, the FSC believes that ‘personal advice’ would be more reflective of the type of advice provided to consumers than the label ‘financial advice.’ The use of the term ‘financial’ may lead consumers to believe that the advice is limited to investments or financial products and that it may not include topics such as insurance advice or strategic advice which can cover a range of topics.

On this basis the FSC is not supportive of the PJC recommendation 2, of replacing ‘personal advice’ with ‘financial advice’.

The FSC also notes the PJC Committee's comments in the report that it has 'not received a significant body of evidence on the proposal to change 'personal advice' to 'financial advice'.[2]

RECOMMENDATION:

The FSC is not supportive of replacing 'personal advice' with 'financial advice' on the basis that 'personal advice' better reflects the nature of the advice provided.

PJC RECOMMENDATION 3:

The committee recommends that to provide 'financial advice' an individual must be registered as a financial adviser.

Pursuant to FSC recommendations in response to the PJC, the FSC is not supportive of replacing 'personal advice' with 'financial advice.' In this context, the FSC has considered whether the provision of 'personal advice' should be limited to someone who is registered as a financial adviser.

It is our understanding that persons who provide personal advice to retail clients on more complex products, defined as 'relevant financial products'[3] (e.g. financial products that are generally considered to be more complex, other than basic banking products, general insurance products or consumer credit insurance products) will be included on the register of financial advisers.

The Explanatory Statement to the Corporations Amendment (Register of Relevant Providers) Regulation 2015 indicates that the scope of the register will capture:

> 'individuals typically labelled 'financial advisers or planners', but also includes a wide range of advisers in related sectors, including stockbrokers, insurance brokers, accountants and some bank employees.'

The breadth of individuals captured on the register relates to those who provide personal advice to retail clients on 'relevant financial products' which are also commonly referred to as Tier 1 products.

Given the nature of the advice provided and complexity of products recommended, the FSC is supportive of limiting the provision of 'personal advice' to persons who:

- provide personal advice to retail clients on Tier 1 products or 'relevant financial products' (which also means they will be included on the new financial adviser register); and

[2] Page 22, Parliamentary Joint Committee on Corporations and Financial Services – Inquiry into proposals to life the professional ethical and education standards in the financial services industry report.

[3] The definition of relevant financial products will exclude 'products which are less complex…that is…basic banking products, general insurance products, consumer credit insurance or a combination of any of these three categories.' Page 4, Explanatory Statement *Corporations Amendment (Register of Relevant Providers) Regulation 2015.*

- have met the minimum education and competency requirements as set out on page 24-25 and Table 1 of this submission.

We note that restricting 'personal advice' will require anyone wishing to provide personal advice on relevant financial products or Tier 1 products to meet the new minimum education and competency standards.

RECOMMENDATION: The FSC is supportive of limiting the provision of 'personal advice' to someone who provides personal advice to retail clients on Tier 1 product or 'relevant financial products' and who has met the minimum education and competency requirements set out on page 24-25 and Table 1 of this submission.

PJC RECOMMENDATION 4:

The committee recommends that the government should bring forward legislation to protect the titles 'financial adviser' and 'financial planner' and require that to be eligible to use the title 'financial adviser', an individual must be registered as a financial adviser.

This envisages that to use the terms 'financial adviser' and 'financial planner' an individual must be providing personal advice and be a member of a professional body.

The FSC is supportive of restricting both terms, namely 'financial adviser' and 'financial planner', to those who:

- provide personal advice to retail clients on tier 1 products/relevant financial products;
- are included on the new financial adviser register; and
- meet minimum education and competency requirements set out on page 24-25 and Table 1 of this submission.

This will mean that anyone who has met the minimum education and competency requirements and is included on the new financial adviser register will be able to call themselves a financial planner or financial adviser, such as an insurance adviser. Whilst they are able to call themselves financial adviser/planner, we note that they should also be free to refer to themselves by other labels. For example, insurance advisers should continue to be free to refer to themselves as insurance advisers if they wish to do so, even though they meet the requirements to call themselves a financial planner/adviser.

In order for any restriction to be meaningful and effective both terms, financial adviser and financial planner, need to be simultaneously regulated to ensure that the terms are not utilised by others.

For example, if only ‘financial adviser’ is restricted to those providing personal advice to retail clients on tier 1 products and who have met the minimum education/competency requirements, then there is the capacity for others who do not provide personal advice on tier 1 products to use the term ‘financial planner’. In this context, for example, someone who provides general advice could use the label financial planner.

This would confuse consumers who are unlikely to understand the difference between a financial adviser or financial planner and this would invalidate any benefits gained from restricting a particular title.

RECOMMENDATION:

The FSC is supportive of restricting the terms ‘financial adviser’ and ‘financial planner’ to those who:

- provide personal advice to retail clients on tier 1 products/ relevant financial products;
- are included on the new financial adviser register; and
- meet the minimum education and competency requirements set out on page 24-25 and Table 1 of this submission.

PJC RECOMMENDATION 5:

The committee recommends that the register of financial advisers:

a) include the information fields detailed in the government's announcement of the register on 24 October 2014;
b) have a unique identifier that follows every individual adviser throughout their career;
c) only list financial advisers on the register when a professional association (which has been approved by the Professional Standards Councils) advises that the adviser has completed the requirements of the Finance Professionals’ Education Council approved professional year and passed the registration exam;
d) record any higher qualification awarded by a professional body to the adviser;
e) annotate any censure or limitation placed on a financial adviser by a professional body, Australian Securities and Investments Commission or Australian Financial Service Licence holder; and

f) <u>highlight that an adviser is no longer authorised to provide financial advice if the adviser has their membership of the nominated professional body suspended or revoked.</u>

In relation to the individual items included within the PJC Recommendation 5, the FSC makes the following comments:

a) The FSC is strongly supportive of the new financial adviser register which will enhance transparency and act as a useful consumer tool.

b) The FSC is supportive of a unique identifier being implemented which follows an adviser throughout their career. The FSC considers it important that the unique identifier also follow the person where they have a gap in their career and then re-joins as an adviser at a later stage. This would ensure that the adviser's history/details are not lost because of any breaks or gaps taken from the role of being an adviser.

   We are supportive of ASIC adding financial advisers to the register when a professional association advises that the new adviser has met the minimum education and competency requirements set out on page 24-25 and Table 1 (which vary depending on whether the person is a new entrant to the industry or entering during the transitional period). It is expected that existing advisers will already be included on the new financial adviser register which commences March 2015.

   With respect to new advisers being added to the financial adviser register, according to the minimum education and competency requirements set out on page 24-25 and Table 1, it is envisaged that once a new adviser has passed the registration exam during their professional year, that they will be in a position to provide 'supervised advice' during their professional year and that they will be added to the adviser register.

c) The FSC is supportive of the register including higher qualifications awarded by a professional body to the adviser.

d) The FSC is supportive of the adviser register including information from ASIC on bans, disqualifications or enforceable undertakings against a financial adviser which will be included in the adviser register.

There is merit in including censures and limitations placed on an adviser by a professional body or Australian Financial Service Licence (AFSL) provided that the censure or limitation is material and meaningful to consumers.

The FSC recommends undertaking a targeted consultation on including material censures or limitations imposed by AFSL's, Professional Bodies or ASIC (other than bans, disqualifications and enforceable undertakings which should be, and will be, included on the financial adviser register) to ensure further disclosure is meaningful to consumers.

e) The FSC is supportive of the register noting that an adviser is no longer authorised to provide personal advice if the adviser has their membership of the nominated professional body suspended or revoked.

RECOMMENDATION:

Subject to the FSC's feedback provided in response to the PJC's recommendation 5, the FSC is supportive of many aspects contained within this recommendation.

Specifically, the FSC is supportive of:

- the enhanced adviser register and a unique identifier which follows an adviser throughout their career (even where they have a break and re-join the industry);
- a new adviser being added to the register when the new adviser has met the minimum education and competency requirements set out on page 24-25 and Table 1 (noting that advisers will be added to the register once they pass the registration exam, even where this takes place during the professional year);
- the inclusion of higher qualifications awarded by a professional body;
- the inclusion of information about any bans, disqualifications or enforceable undertakings by ASIC, as well as recommending targeted consultation on including material censures or limitations imposed by AFSL's, Professional Bodies on the adviser register to ensure further disclosure is meaningful to consumers; and
- the register noting that an adviser is no longer authorised to provide personal advice if their membership of their nominated professional body is suspended or revoked.

PJC RECOMMENDATION 6

The committee recommends that the government consider proposals to increase fees for organisational licensees to reflect the scale of their financial advice operations, in the context of a broader review of ASIC's fees and charges.

The FSC is supportive of organisational licence fees reflecting the scale of their financial advice organisation, however broader industry consultation is needed on the licensee fee which must be considered in line with other fees. For example, there will be increased fees for advisers being added to the adviser register, as well as increased fees for any changes made to adviser details on the adviser register, and there is the scope for increased organisational licensee fees.

RECOMMENDATION:

The FSC is supportive of organisational licensee fees reflecting the scale of the advice organisation subject to broader industry consultation on fees.

PJC RECOMMENDATION 7:

The committee recommends that:

- the mandatory minimum educational standard for financial advisers should be increased to a degree qualification at Australian Qualification Framework level seven; and
- the Finance Professionals' Education Council should set the core and sector specific requirements for Australian Qualifications Framework level seven courses.

Minimum Education and Competency Requirements

The FSC is supportive of increasing minimum education and competency requirements for those who provide personal advice to retail clients on Tier 1/relevant products.

The increased standards should be subject to suitable transitional periods and mechanisms to support new advisers and ensure existing advisers meet relevant requirements. There should also be a mechanism for those with relevant industry experience to transition to the role of financial adviser/planner with an appropriate transition framework.

The FSC supports the requirements set out in Table 1 for new, existing and transitioning advisers.

Table 1: Education and Competency Requirements

No.	Requirements	New Advisers	Existing Advisers (transition approach)	Transitional period – persons with relevant experience in the provision of advice
1.	**Relevant degree (AQF level 7 or above) for new entrants** Courses will be approved by the Independent Body and included on a register of approved courses held by the Independent Body. This will assist with quality control re: courses which meet the Council's requirements.	**Relevant degree**	**NA**	**NA**
2.	**Mandatory Ethics Training/course** Ethics courses to be approved by the Independent Body to ensure quality control and included on the register of approved courses.	**Yes**	**Yes**	**Yes**
3.	**CPD** 30 hour CPD framework (annually) aligning to an adviser's authorisation and specialisation. Increased ethics component should be part of CPD framework.	**Yes**	**Yes**	**Yes**
4.	**Registration Exam** Successful completion of registration exam. Successful completion of the exam is also necessary for new advisers that wish to provide supervised advice during professional year.	**Yes**	**Yes**	**Yes**

5.	**Professional Year** New advisers operate under the supervision of a suitably experienced adviser. Once the registration exam has been passed, the new adviser would be added to the financial adviser register and can provide advice under supervision (for example SoA's are reviewed by an appropriate person during the professional year).	**Yes**	**NA**	**NA**
6.	**Professional Association Membership**	**Yes**	**Yes**	**Yes**

The FSC is supportive of increasing requirements for *new advisers* which involves the completion of:

- a relevant degree at AQF level 7 or above;
- ethics training/course;
- continuing professional development;
- a professional year;
- a registration exam; and
- membership of a professional association.

The FSC is supportive of increasing requirements for *existing advisers* which involves completing:

- the registration exam – completion of a single registration exam to demonstrate competency;
- ethics training/course;
- continuing professional development; and
- membership of a professional association.

To assist existing advisers to transition, the FSC is supportive of existing advisers completing the registration exam on a one-off basis as sufficient means for demonstrating competency. Should there however be the view that further education should be included for existing advisers, then the FSC would be supportive of an options approach being offered to existing advisers. The option would consist of either completing a relevant course at AQF level 7 or above (with the independent body maintaining a register of approved courses that meet relevant degree requirements), or by completing the registration exam. We do not envisage that both an exam and the course would be necessary for existing advisers.

Transitional period - Persons with relevant experience in the provision of advice

Financial planners enter the industry from a range of different professions and a variety of different ways. This often also includes starting out in the area of paraplanning, and preparation of Statement of Advice documents for use by advisers and clients. Individuals who have been working in a role that is related to the provision of advice, although themselves not yet licensed to advise, are highly likely to have acquired invaluable knowledge and experience relating to the provision of advice and this knowledge and experience should be recognised through appropriate transitional arrangements by a defined transitional period.

The FSC is supportive of facilitating *persons with relevant experience in the provision of advice* from becoming financial advisers. To assist these persons becoming financial advisers/planners during a defined transitional period, the FSC is supportive of those persons completing:

- the registration exam;
- ethics training/course;
- continuing professional development; and
- membership of a professional association.

General comments

The FSC is supportive of increasing the education and competency requirements of financial advisers as outlined above on the basis that they are subject to suitable and achievable transition periods. To help serve consumers, advisers and the industry, it is essential the transitional period enable the new framework to be developed and implemented robustly and without compromising quality. This means the transition timeframe should not be rushed at the expense of getting the new framework right otherwise it will limit the benefits to consumers and industry alike.

Professional Year

Development of the professional year framework should consider both consumer and practical considerations that may impact advice delivery. Licensees are required to have supervision and monitoring frameworks in place to ensure that advice is appropriate. The role of the senior adviser should be one of ongoing mentoring and oversight during the professional year. It should not subsume elements of supervision and monitoring more appropriately and efficiently performed elsewhere within the licensees framework. As recommended by the PJC and noted in the transitional schedule, we anticipate the Independent Body will develop the professional year framework.

<u>Finance Professionals' Education Council/Independent Body</u>

The FSC is supportive of an independent body (referred to in this submission as 'Independent Body') being set up to develop and oversee the educational framework for the advice industry, complementing ASIC's role of enforcement in the advice industry.

A key objective should be to ensure the appropriate framework is in place for the Independent Body to perform its functions by:

- setting initial and ongoing educational requirements (as well as identifying any 'advanced competency' to enable appropriate specialisations);
- identifying and approving courses which meet the Independent Body's requirements such as relevant university degree, relevant ethics courses and courses AQF level 7 or above;
- maintaining the register of approved courses; and
- developing exam requirements and nominating an independent exam provider.

It is also of critical importance that the Independent Body has a suitable composition including ASIC, TPB and have ministerial appointment as discussed in response to PJC's Recommendation 10.

RECOMMENDATION: The FSC is supportive of increasing the mandatory education requirements as outlined in Table 1: Education and Competency Requirements and for an Independent Body to establish the initial and ongoing education and competency requirements.

<u>PJC RECOMMENDATION 8:</u>

<u>The committee recommends that ASIC should only list a financial adviser on the register when they have:</u>

- <u>satisfactorily completed a structured professional year and passed the assessed components; and</u>
- <u>passed a registration exam set by the Finance Professionals' Education Council administered by an independent invigilator.</u>

Further to comments provided in relation to FSC recommendations in response to the PJC, the FSC supports ASIC adding financial advisers when they have met minimum education and competency requirements set out in Table 1, as confirmed by a Professional Association. The requirements also envisage that a new adviser will be added to the financial adviser register once they have successfully completed the registration exam such that they can provide supervised advice during their professional year.

RECOMMENDATION:

The FSC is supportive of ASIC listing advisers on the register when they have met the minimum education and competency requirements in Table 1 as confirmed by the nominated Professional Association.

PJC RECOMMENDATION 9:

The committee recommends that the government require mandatory ongoing professional development for financial advisers that:

- is set by their professional association in accordance with Professional Standards Councils requirements; and
- achieves a level of cross industry standardisation recommended by the Finance Professionals' Education Council.

The FSC is supportive of advisers undertaking ongoing professional development set by the professional association, with the Independent Body facilitating cross industry standardisation.

The FSC envisages that the CPD framework would consider core CPD requirements which everyone would complete, and specialisations which should be completed by those with relevant specialisations e.g. SMSF, Risk Insurance.

The CPD framework should also consider the requirements of the Tax Practitioners Board for Tax Financial Advisers. It is critical that the new education framework integrates, and is complementary to, the Tax Financial Adviser framework as far as is possible to reduce unnecessary overlap and inefficiencies that arise from having two separate initial and ongoing education requirements.

RECOMMENDATION:

The FSC is supportive of ongoing professional development being set by their professional association, with the Independent Body facilitating cross industry standardisation. The CPD framework should encompass core CPD requirements for all to complete and cater for specialisations (such as SMSF or risk insurance advice).

PJC RECOMMENDATION 10:

The committee recommends that the professional associations establish an independent Finance Professionals' Education Council that:

a) is controlled and funded by professional associations which have been approved by the Professional Standards Councils;
b) comprises a representative from each professional association (which has been approved by the Professional Standards Councils), an agreed number of academics, at least one consumer advocate, preferably two would who represent different sectors, and an ethicist;
c) receives advice from ASIC about local and international trends and best practices to inform ongoing curriculum review;
d) sets curriculum requirements at the Australian Qualifications Framework level seven standard for core subjects and sector specific subjects (e.g. Self-Managed Superannuation Fund services, financial advice, insurance/risk or markets);
e) develops a standardised framework and standard for the graduate professional year to be administered by professional associations;
f) develops and administers through an external, independent invigilator a registration exam at the end of the professional year; and
g) establishes and maintains the professional pathway for financial advisers including recognised prior learning provisions and continuing professional development.

The FSC is supportive of an Independent Body being set up to develop and oversee the educational framework for the advice industry, complementing ASIC's role of enforcement in the advice industry.

However, key objectives should be to ensure the suitable composition of the Independent Body and that an appropriate framework is in place for the Independent Body to perform its functions:

a) Control and funding of the Independent Body

The current framework envisages that the body would be funded by professional associations who have been approved by the Professional Standards Council.

We understand that approval by the Professional Standards Council can be a lengthy process which can take over 12 months. Given the lengthy registration process, we would be concerned that there may not be adequate funding for the new body for quite a period of time. It could take organisations a considerable period of time to obtain approval/recognition by the Professional Standards Council and there may be quite a period of time between the first organisation being approved and another organisation being approved, which would help fund the new independent body. Appropriate funding of the new independent body is absolutely essential to ensure it can carry out its functions. To help provide appropriate funding the FSC is supportive of a revised ASIC levy meeting initial and ongoing funding requirements of the independent body.

From a control perspective, given the importance of appropriate governance and composition the FSC envisages that the Board of the Independent Body would have broader composition than is currently envisaged and that the Board would control the body. Details of the Board Composition are outlined in the following section.

b) Independent Body Composition

The FSC considers that the Independent Body needs to be composed of those with relevant knowledge and understanding of financial advice, education knowledge, as well as have direct regulator input from Australian Securities and Investments Commission (ASIC) and the Tax Practitioners Board (TPB).

Representation by ASIC and the TPB is critical to ensuring that the minimum education requirements for tax (financial) advisers can be integrated with the requirements of financial adviser/planners (there are currently two separate frameworks and the objective should be to facilitate a single minimum education and competency framework as far as is possible).

In addition to ASIC's involvement, we are also supportive of a ministerial appointment being included on the Board.

On the basis of the above considerations the FSC is supportive of the independent body consisting of:

- representatives from ASIC and the TPB;
- education providers with knowledge of financial advice;
- experienced individuals from the industry/advisers; and
- an independent chair such as an academic.

The independent body should also incorporate a mechanism for professional associations, licensees and consumer representatives to provide input into initial and ongoing education requirements through a variety of sub-committees which include these stakeholders.

Whilst the committee did not recommend that licensees be included as relevant stakeholders as part of its recommendation, regard must be given to the regulatory framework which places ultimate responsibility for the provision of advice, and the conduct of advisers, including the failure to meet regulatory requirements, with the licensee. Given the regulatory responsibilities imposed on licensees it is absolutely critical that licensees have a role with, and provide input to, the education requirements of financial advisers. This could be achieved by licensee involvement on a sub-committee of the body.

RECOMMENDATION:

To ensure appropriate funding, the FSC is supportive of an Independent Body being funded by an ASIC industry levy with Ministerial appointees. It is recommended that the Board be comprised of:

- representatives from ASIC and the TPB;
- education providers with knowledge of financial advice;
- experienced individuals from the industry/advisers; and
- independent chair such as an academic.

To support input from key stakeholders the FSC also recommends that stakeholders have direct involvement with the Independent Body via a variety of sub-committees which include:

- professional associations;
- consumer representation; and
- licensees (given regulatory responsibilities imposed on licensees for adviser competency it is important for licensees to be able to provide input).

PJC RECOMMENDATION 11:

The committee recommends that professional associations representing individuals in the financial services industry be required to establish codes of ethics that are compliant with the requirements of a Professional Standards Scheme and that are approved by the Professional Standards Council (PSC).

The FSC is supportive of Professional Associations establishing code of ethics that are compliant with Professional Standards Scheme and Professional Standards Council requirements. To enable codes of ethics to be approved with efficiency and speed, the FSC recommends that the PSC approve codes of ethics independently of any application to approve a Professional Association. This would ensure codes of ethics could be approved/implemented promptly and not be delayed by any application for recognition as a Professional Association.

RECOMMENDATION:
The FSC supports Professional Associations establishing Codes of Ethics which meet Professional Standards Council (PSC) requirements. Codes of Ethics should be approved independently of any application for recognition as a Professional Association.

PJC RECOMMENDATION 12:

The committee recommends that financial sector professional associations that wish to have representation on the Finance Professionals' Education Council and to be able to make recommendations to ASIC regarding the registration of financial advisers, should be required to establish Professional Standards Schemes under PSC, within three years**.**

The FSC is supportive of Professional Associations establishing Professional Standards Schemes under the PSC. We understand that establishing Professional Standards Schemes can take time, and that the implementation timeframe should be subject to guidance from the PSC on the time required to have the scheme up and running.

In relation to having representation with the new Independent Body, for the reasons outlined above regarding the importance and the role of licensees in the existing regulatory and licensing framework, we do not believe that any recommendations to ASIC or the Independent Body regarding the registration of financial advisers should be restricted to Professional Associations that are represented on the Independent Body. It is imperative for licensees and other relevant stakeholders to have the ongoing capacity to engage in dialogue and make recommendations to ASIC as well as the Independent Body and as such we do not support the restriction recommended.

RECOMMENDATION:
The FSC is supportive of Professional Associations establishing Professional Standards Schemes. The PSC should provide timing guidance on when the Professional Standards Scheme can be up and running.
Given the regulatory and licensing framework, the FSC also believes it is critical that licensees and relevant stakeholders can continue to make recommendations to ASIC and the Independent Body about the registration of Advisers. As such we do not support the restriction that only Professional Associations can provide recommendations to ASIC and the Independent Body.

PJC RECOMMENDATION 13:

The committee recommends that any individual wishing to provide financial advice be required to be a member of a professional body that is operating under a Professional Standards Scheme approved by the Professional Standards Councils and to meet their educational, professional year and registration exam requirements.

The FSC is supportive of those wishing to provide advice being members of a professional association operating under a Professional Standards Scheme recognised by the PSC. The FSC is also supportive of the education and competency requirements which are set out in Table 1 of this submission.

RECOMMENDATION: The FSC is supportive of advisers being members of a professional association and those associations being recognised by the Professional Standards Council. In relation to education and registration requirements the FSC is supportive of advisers meeting the education and competency requirements as set out in Table 1 of this submission.

PJC RECOMMENDATION 14:

The committee recommends that government require implementation of the recommendations in accordance with the transitional schedule outlined in the table below.

The FSC would like to see the prompt and efficient implementation of increased adviser standards and the new framework. Implementing this framework will positively transform the advice industry, raise the standards of financial advisers and provide consumer confidence in financial advisers and the advice industry, if implemented properly.

We also recognise there is a great deal of work involved with developing and implementing the new framework with many of the recommendations taking time to develop and appropriate implementation to occur.

This includes confirming the framework and composition of the Independent Body, allocating funding, enabling appropriate courses to be identified, stakeholders to given adequate time to complete the required work – e.g. obtaining recognition as a Professional Association, developing relevant university, exam, ethics courses and appropriate CPD and professional year frameworks.

These objectives should not be compromised in a rush to meet desirable but unachievable timeframes or even excessively tight timeframes. It is more important to ensure the development and implementation of a robust education and competency framework which will serve consumers, advisers and the industry for years and even decades to come.

Whilst we would like to see the new advice framework implemented efficiently and speedily, adjustments to the proposed transition timeframe may be necessary. The FSC proposes that the relevant dates be linked to the establishment of the Independent Body and proposes the implementation timeframe set out in Table 2 of this submission.

Table 2: Implementation timeframe

Transitional arrangements and timeframes	Proposed dates
Provisional registration (available to existing and transitioning advisers from the implementation of the proposed government register until 3.5 years from establishment of new body to address the goal of transparency)	Provisional registration available from establishment of independent body/FPEC until 3.5 years from establishment of new body
Independent Body established – to enable new constituents to be identified and association funded	Preference for the body to be established as soon as possible however no later than June 2016
Independent Body/FPEC releases AQF 7 education standards for core and professional stream subjects. The framework will need to cater for the different advice providers who provide personal advice to retail clients on tier 1/relevant financial products	1 year from establishment of independent body/FPEC, or earlier if possible
Establishment of code of ethics compliant with Professional Standards Council/Scheme requirements	1 year from establishment of independent body/FPEC, or earlier if possible
Independent Body/FPEC approved AQF 7 courses available to commence. The framework will need to cater for the different advice providers who provide personal advice to retail clients on tier 1/relevant financial products	2 years from establishment of independent body/FPEC, or earlier if possible
Independent body/FPEC releases professional year requirements including prior learning framework for existing advisers	18 months from establishment of independent body/FPEC or earlier if possible

Professional associations operating under PSC Professional Standards Schemes	Subject to guidance by the PSC as to when Professional Associations are likely to be approved and operational under the Professional Standards Schemes
Target date for existing advisers to qualify for full registration – on the basis that the registration exam is the requirement for full registration	Within 12 months of the registration exam being available
Cut-off date for full registration – provisional registration no longer available	Within 3.5 years from establishment of independent body/FPEC.

RECOMMENDATION:

The FSC would like to see the new advice framework implemented promptly and efficiently, however recognises that implementation of the many recommendations will require time and proposes that the timeframes be linked to the establishment of the new Independent Body as set out in Table 2, including appropriate transitional arrangements for existing and transitioning advisers as set out in Table 1 of the submission.

CHAPTER 2: FUNDS MANAGEMENT AND INVESTMENT

This chapter provides a response to the FSI's hypothesis on the investment management industry and also answers specific questions on investment matters.

Section A: Funds Management

The FSI interim and final reports state that 'the superannuation system is not operationally efficient due to a lack of strong price-based competition'. Further the final report (page 103) states: 'Factors driving higher costs and fees and a lack of price-based competition in Australia include:

- Supply side issues: market fragmentation; costly asset management and active investment strategies…;
- Demand-side issues: weak member-driven competition due to lack of member interest…lack of comparability of fees and performance…'

We are responding to these statements in this section; namely that investment fees in the system are high, there is a lack of price based competition and active investment strategies are costly and do not add value. In our submission to the FSI interim report, FSC provided data and narrative on the strong competition in funds management in Australia and we reiterate our messages here. We ask the Government to recognise that strong competition in superannuation and funds management has resulted in investment fees which are among the worlds' lowest (if not the lowest).

This section outlines several surveys and research pieces on Australia's competitive fees and performance in active management. Australia's superannuation funds and fund managers look after a pool of funds under management of $2.5 trillion and so it is important that these messages are based on accurate data and the correct conclusions are presented to the Government and the Australian public. It is important that any future policy decisions are not based on the incorrect assertions outlined in the FSI interim and final reports.

In response to statements by the FSI, our submission outlines the following key messages:

- the Australian funds management industry has very low fees on a global scale;
- there is an important place for both active and passive strategies in investing, and data shows active managers can and do outperform the market; and
- the Australian investment management industry is highly competitive.

Investment fees in the superannuation system

The Inquiry outlined its concerns that the scale of the Australian system has not resulted in lower fees and costs. The final report (page 102) states 'if fees and costs could be reduced, net returns, and ultimately retirement outcomes, could be higher'.

Further, assertions are made about investment fee components of total super fees charged to members, stating 'data suggests that higher MySuper investment fees do not strongly correlate with the allocation to growth assets' (page 107).

The fees charged to superannuation members are made up of several components and these differ from fund to fund. Generally the fee is comprised of an administration fee and an investment management fee. Under the MySuper reforms, trustees now need to break down fees into investment and administration components. These fee components are now disclosed in APRA's MySuper comparative tables.

Administration fees are based on costs the trustee incurs when operating a superannuation fund, which itself is a factor of operating expense and cost of compliance with regulatory requirements.

The investment management fee is the fee charged by the fund manager to the superannuation fund for managing the assets. Because of the scale of most superannuation funds, the fee charged by investment managers is normally discounted significantly from the publically-quoted retail fee rates.

This is one reason why numerous research reports claiming fees in Australia are high are not comparing like-with-like, as they tend to use published retail rates. These published rates are not the rates being charged to superannuation funds. Further, many reports compare administration fees of pension funds globally to Australia's total investment and administration fee.

To better understand the factors influencing investment management fees, the global comparisons and returns from active investment management, this chapter considers several studies on the performance and fees of Australia's fund managers.

Fee comparison reports – data

The FSC disputes the premise of various submissions and pieces of research that claim to demonstrate that fees in the Australian system are unjustifiably high. The data on which these reports were based is inappropriate and misleading, resulting in false conclusions. This point was accepted by the FSI in the final report, however it was again concluded that Australia had high fees on a global scale. This is not the case.

In particular, OECD data is inconsistent as different international pension systems report fees differently, preventing direct comparisons from being established. This critical point was neglected by organisations that sought to make such comparison.

Further, OECD data does not take into account different levels of member servicing in the different jurisdictions – Australia largely operates on a full service model. Member servicing is a significant contributor to the cost basis for a superannuation fund and, in many instances, should not be discounted where they are important to an effectively functioning system.

For example, government run pension funds, such as the two Norwegian funds, 'Government Pension Fund – Norway' and the 'Government Pension Fund – Global', do not provide any degree of member servicing. Those funds are administered through an arm of Norway's Central Bank and are not required to have any notable interaction with the public, for which it is ultimately intended to provide.

The FSC notes the Inquiry's comparison in the interim report of the Australian system to the auction model for default contributions in Chile.

The rationale provided by both the Grattan Institute report and the FSI interim report, is that there is little competition in the Australian system and fees are high. However, there is vigorous competition in the Australian superannuation and funds management industries, as discussed below.

The Grattan Institute report found Chile's fees were about one-third of Australia's default MySuper fees, but the report wrongly compared Chilean administration fees with the total of administration and investment fees for MySuper options.

Similarly, studies comparing active and passive strategies to conclude that active management does not add value are often using inaccurate fee levels. This is elaborated below.

Investment fees

Schroders Investment Management Australia undertook a research piece entitled 'Are Australians really paying too much for superannuation?'. The report compares fees over time, across different segments of the market in Australia, and benchmarks against other jurisdictions. It also covers active management and why many studies comparing active and passive strategies are not using accurate fee levels.

The report outlines that the reasons so many institutions globally utilise active asset management is, in part:

- a recognition that the universe of active managers to which this statement applies is significantly larger than the universe of professional money managers (e.g. every direct investor in the equity market who doesn't own the index is an active manager);
- the fees paid by institutions for active management are substantially lower than retail fee scales on which most 'active vs passive' analysis is conducted, and consequently the hurdle rate is considerably lower for institutions (as discussed above);
- risk is an important consideration in the trade-off, not just return, and investing in the index does not manage risk, you take what is on offer in the index;
- the universe of available investments to an active approach is often broader than that in the 'index';
- index management is cheap (but not free as often assumed) as a result of simplistic and pre-determined investment weightings. In almost all cases this does not equate to a risk or return outcome which is necessarily superior to active management, nor tax efficient; and
- while some subcomponents of the asset allocation can be passively managed, the overall fund exposure needs to be actively managed (i.e. active asset allocation).

The report argues that the real benefit of asset management is in fact managing exposure to the asset classes itself, not just the management of the sub-asset classes which is where most 'active vs passive' research is conducted.

From an Australian investor's perspective, a brief examination of the Mercer Investment Survey for the periods to 30 June 2014 shows the outperformance of median performance of active managers versus the relevant index as follows.

Table 3: Excess Performance of active investment managers to 30 June 2014 (before fees)

Excess performance (% p.a.)	1yr	3yrs	5yrs	10yrs
Australian Equities	1.1	1.3	0.9	1.2
Global equities	0.3	0.2	0.7	0.8
Australian Bonds	0.4	0.4	0.8	0.3
Aus Small Cap Equities	7.9	12.4	10.8	7.2

Source: Mercers, Analysis of Long Only managers versus relevant benchmark

The report notes that these are not asset weighted (and nor are most active vs passive surveys), however it does appear that the average professional money manager in Australia has outperformed the relevant index (before deduction of fees) over 1, 3, 5 and 10 years for Australian equities, global equities, Australian bonds and Australian small cap equities. Why the paradox if this is a zero sum game? Again, the professional investment management industry is only a portion of the total active assets in the market under active management. It would be our assertion that non-professional holders of listed assets provide the opportunity for professional active managers to outperform. This is particularly obvious in the Australian small cap equities sector where the outperformance of professional managers is quite high.

This concurs with the decision by most superannuation funds in Australia to utilise active managers for major listed asset classes as the fees they pay would generally be lower than the historical outperformance of the average manager.

FSC also engaged Chant West Financial Services to examine the impact of asset allocation and management style on historical member returns. We outlined the results of this research in our submission to the FSI Interim Report.

The Chant West results come to the same conclusion as the Mercer data above – that active managers can and do beat the market. The Chant West research collected returns for Australian equities and International equities against the relevant benchmark. Australian shares and international equities are typically the largest component of a balanced superannuation default investment option. At almost 50 per cent of the average allocation, performance of both Australian and international equity sectors is incredibly important.

Chant West considered whether investment managers operating such portfolios would beat the index on a historical basis – also over the past 5, 7, 10 and 15 years. Over every time period in the past 15 years, Australian share managers have, on average, outperformed the S&P ASX 300 (before fees). In both asset classes, over the past 15 years, the average return above the index outstrips the premium paid for outperformance.

This research shows that Australia's investment managers have outperformed the index for Australian and International equity portfolios as a benchmark over the past 15 years. It provides an evidence base that effective trustees, engaging an investment manager in a competitive marketplace, can and do beat the market.

Global perspective on investment management

It is also important to consider the funds management industry's competitive position relative to other markets. The FSI interim report argued that Australian fees were high on a global scale. In the final report, the Inquiry accepts the arguments that comparisons are difficult due to data issues, yet then wrongly concluded that fees are higher due to the unique features of our system. FSC reiterates here that investment fees in Australia are not higher, in fact they are among the lowest globally despite the unique features of our system including high levels of member servicing.

Despite views to the contrary, the primary reason that investment management fees are competitive in Australia is that superannuation trustees use their scale and experience to achieve lower costs.

This is a fiercely competitive marketplace. The MySuper data is supported by the global research house Morningstar which states the following in its 2013 Global Fund Investor Experience Report:

> "Australia fares very well with respect to fees and expenses. Australian equity, allocation and fixed income funds are some of the least expensive globally, with only the much larger United States charging consistently lower total expense ratios."

In order to determine whether or not Australian superannuation funds are paying high fees to fund managers, we decided to undertake research into investment fees.

We conducted research to ascertain the relative level of fees charged in Australia compared to other parts of the world. Specifically, we conducted a survey of several large global fund managers on their fees charged for the same products in Australia and other jurisdictions. Collectively, the surveyed manager's funds under management (FUM) in Australia total around $110 billion and $7.1 trillion globally.

The methodology was as follows. In order to gain an accurate comparison we collected the *actual* fees charged (and not the published rates) on products that are sold in multiple jurisdictions. This means we compared the same product sold around the world. The products used were: global equities, global property securities, emerging markets and global bonds. The jurisdictions compared were Australia, US, Europe ex UK, UK, Asia ex Japan and Japan. As fees can change based on the size of the investment, the fee rates collected were based on a $100 million mandate.

The results showed:

- global equities rates are almost 11 bps or 20% lower on average in Australia than the other jurisdictions;
- global property securities are 6 bps or 12% lower on average in Australia than the other jurisdictions;
- emerging markets are 13 bps or 17% lower on average in Australia than the other jurisdictions; and
- global bonds are about equal to other jurisdictions on average.

These results, comprising data from some of the world's largest fund managers, show that investment management fees charged in Australia are among the world's lowest (if not the lowest). Anecdotally, the FSC heard from several fund managers that on most occasions, approval had to be sought on a regular basis from head office to lower the fees used in Australia in order to win business. While reaffirming Morningstar's results, our survey shows Australia has lower fees than the United States on average, based on a $100 million mandate.

Further, if the fees charged to Australian investors are significantly lowered further (with a larger gap between Australia and overseas jurisdictions); we run the risk of these global managers removing their products and investment capabilities from Australia. This would reduce competition and would adversely impact investors.

Conclusion

The FSI interim and final reports conclude that the superannuation and funds management sectors lack price-based competition that fees are high on a global scale and that active management does not add value for superannuation members.

Australia's funds management industry is highly competitive and makes a significant contribution to Australia's economy and the retirement outcomes of Australians.

The research outlined in this section shows both the competitiveness of Australia's investment industry and the positive returns active managers have been able to achieve. The survey of our biggest global fund manager members shows consistently low fees in Australia on a global scale.

The success of Australia's superannuation and funds management industry has been in part due to the high level of competition, innovation and professional expertise. In addition to Australia's low fees, data shows that investment managers can and do beat the benchmark with active strategies, adding value for superannuation members.

RECOMMENDATION:

FSC recommends that the FSI's analysis on the funds management sector in Australia should not be used in any future policy decisions by the Government. It is important that any policies affecting competition and fees in the system are based on accurate data so as not to create adverse outcomes.

Section B: Investment

FSI RECOMMENDATION 30:

Review the state of competition in the sector every three years, improve reporting of how regulators balance competition against their core objectives, identify barriers to cross-border provision of financial services and include consideration of competition in the Australian Securities and Investments Commission's mandate.

The FSC is supportive of the FSI's recommendation on competition and believe an increased focus on competition will improve the regulatory process. We support the recommendation that ASIC take into account competition issues as part of its core regulatory role, and to balance competition considerations against other regulatory objectives.

The FSC has consistently advocated for the Government to remove impediments to, and better facilitate, financial services trade particularly in funds management. FSC reiterates the need for greater Government action to remove barriers to cross-border provision of financial services including tax impediments, enabling a range of collective investment vehicles and implementing an Investment Manager Regime.

We previously submitted that ASIC's mandate should include international competitiveness and reiterate that here.

The FSC argues that this balance should also be applied to decisions by Treasury that have cross border application, so that first order, short term 'costs to revenue' are balanced against growing industry and longer term gains in higher corporate and personal income tax.

Competition can not be improved in isolation from taxation regime and we urge the Government to consider competitive and efficient tax settings.

There are many barriers that exist to cross border provision of financial services. From a Government coordination point of view, there is no one agency responsible for international financial services issues and there has been no implementation of free trade agreements through mutual recognition. This has meant that industry has not been able to effectively access the benefits of these agreements.

We support and congratulate the Government on the recent FTAs with Japan, Korea and China and the upcoming FTA with India. We urge the Government to ensure these FTAs are able to be utilised by the financial services industry through mutual recognition between regulators.

International coordination

In Australia, high level *domestic financial stability* coordination between regulatory agencies is achieved through informal arrangements through the Council of Financial Regulators (CFR). In many jurisdictions, regulators have begun to coordinate through formal arrangements and legislation. This has been the case in the US, the UK, the EU, Sweden and Norway.

The CFR is an advisory body comprising representatives of ASIC, RBA, Treasury and APRA and coordination is mandated through MOUs. The CFR sits on some international boards relating to financial regulation.

Neither international integration nor Australian competiveness is in CFR's mandate, and as it is an advisory body it does not fit the necessary model for a coordination body as described in the FSI interim report, and which is required in this area.

Australian regulators' cooperation arrangements need to be enshrined in legislation and international integration issues should be included in their mandates. Under this new international mandate for the regulators, an ASIC commissioner in particular should be appointed to specifically deal with these issues.

RECOMMENDATION:

Cooperation of the various regulatory agencies should be legislated and international competitiveness issues included in their mandates. An ASIC commissioner should be appointed to specifically deal with international trade issues.

Free Trade Agreements

Several major FTAs have been negotiated by DFAT with major Asian trading nations. Both the Korean and Japanese agreements have excellent sections on financial services, however many of the previous commitments in financial services have never been implemented or established so they can actually be used by businesses.

This is because there is no agency responsible for the implementation of the agreements. This could explain the lack of impact of FTAs and the low functional usefulness of the mutual recognition arrangements negotiated thus far.

Australia has a poor record of realising the benefits of bilateral free trade agreements. Where market access commitments are made within the financial services chapter of an agreement, it is essential that a whole of government implementation occurs. ASIC and DFAT should develop an implementation policy for the financial services chapters of free trade agreements and mutual recognition agreements.

The Government should look to further strengthen financial services trade with both Korea and Japan following the successful negotiation of the KAFTA and the JAEPA. It is essential that these agreements are fully implemented so that both jurisdictions can capitalise on these cross border relationships.

In order for this to occur, the FSC urges ASIC to progress mutual recognition so both FTAs are fully leveraged for Australian industry. Commencement of discussions with the relevant Korean and Japanese regulators should be progressed as soon as possible. In particular, investigation of the potential for mutual recognition of financial service licensing and investment product offerings should be undertaken in conjunction with ASIC's counterparts in Korea and Japan.

RECOMMENDATION: ASIC should ensure market access is available for all existing FTAs with mutual recognition between regulators.

<u>FSI RECOMMENDATION 42:</u>

<u>Support Government’s review of the Corporations and Markets Advisory Committee’s recommendations on managed investment schemes, giving priorities to matters relating to:</u>

- <u>Consumer detriment, including illiquid schemes and freezing of funds</u>
- <u>Regulatory architecture impeding cross-border transactions and mutual recognition arrangements.</u>

FSC supports the recommendation to prioritise regulatory architecture impeding cross-border transaction and mutual recognition arrangements and has consistently advocated for this.

As a heavily regulated industry, regulation impacts the competitiveness of the financial services industry. The 2009 Johnson Report into 'Australia as a financial centre' provided a framework to resolve many of the issues which were making it difficult for foreign investors to access Australian manufactured funds.

Major impediments include: tax arrangements, collective investment vehicle legislation, regulatory settings, a lack of understanding of our system within Asia and a lack of coordination of international issues by various government agencies.

The Johnson Review noted that Australia has arguably the most sophisticated and advanced financial sector in the region and that there are significant opportunities to expand our exports to the region from a very low base.

The FSC agrees with the recommendations from this report and recommends the Government implement outstanding recommendations which will be vital in increasing Australia's international integration.

Asia Region Funds Passport

There is much to be done domestically in order to increase exports and make Australia a financial centre in the region, including implementation of the Asia Region Funds Passport (ARFP).

The ARFP is the FSC's preferred regional vehicle to increase integration in financial services. It will not only increase choice for retail investors but will increase regional cross-border capital flows, trade and investment.

A cost benefit analysis conducted by APEC[4] shows that efficiencies created through the ARFP could save investors US$20 billion per annum in fund management costs and the initiative could create 17,000 jobs in the region.

Regulatory settings

Australia needs to implement competitive regulation and tax rates in order to attract foreign investment in the sector. Improving the domestic regulatory process to better consider international

[4] APEC Policy Support Unit 'Asia Region Funds Passport: A study of potential economic benefits and costs' July 2014

regulatory developments and competitiveness issues will be paramount, as discussed in the previous section.

FSC supports the recommendation for a UCITS-like fund structure to be created within the Australian regulatory environment. This can be achieved by following the Johnson Report 2009 recommendation to introduce a broader range of tax flow-though vehicles. In particular, introduction of a corporate tax flow through vehicle, with the same characteristics and requirements for eligibility under the existing Managed Investment Trust tax regime, would allow Australian fund managers to compete globally.

The FSC recommendations listed below are the key domestic impediments to international integration generally as well as for the ARFP:

- A dedicated whole of government resource be established to promote Australian competitiveness.
- ASIC pursues mutual recognition arrangements with economies with which we have current and future free trade agreements (i.e. Japan, Korea, China and India).
- Increase political level and regulatory engagement on trade and competiveness issues.
- The FSC recommends the government continue the commitment to implement a world class Investment Manager Regime (IMR) with wide application to a variety of offshore investor types. The regime must strive for equality of taxation outcomes for foreign investors so that investors using an Australian intermediary receive the same treatment as those investing directly.
- The FSC recommends that the Government release the Board of Taxation report and introduce a Collective Investment Vehicle (CIV) regime comprising a broader range of tax flow-through CIVs to allow Australian based fund managers to compete more effectively internationally.
- Allow Australian Managed Investment Trusts to elect into capital account treatment for equity-like investment, such as interests in UCITS.
- FSC research finds that state-based trust law is not fit for modern commercial and personal trusts.
- FSC recommends a federal Alternative Australian Trusts Act be established to act alongside the general law.
- The FSC recommends that the government amend taxation law to specifically allow multiple fund classes to be operated for different currencies.

RECOMMENDATION:

The regulatory process better considers international competitiveness and the outstanding recommendations from the Johnson Review 2009 are implemented as a matter of priority.

Managed investment scheme regulation – general

FSC does not support the need for a holistic review of managed investments regulation – such a review would be a significant exercise and is not warranted. Responsible entities of registered managed investment schemes are subject to numerous and extensive AFS licensee obligations (including relating to conduct and disclosure) as well as obligations in Chapter 5C of the Corporations Act as a responsible entity (many of these obligations are also extended to officers and, in some cases, to employees, of responsible entities).

FSI Recommendation 42 states in essence that it supports the Government *undertaking a review of CAMAC's recommendations on managed investment schemes*, giving priority to matters relating to (1): the regulation of illiquid schemes (below) and (2): regulatory architecture impeding cross-border transactions and mutual recognition arrangements (above).

It is not clear if FSI Recommendation 42 is intended to particularise (and limit) the specific items for which it recommends the Government review (that is, limited to items (1) (illiquid schemes regulation) and (2) (regulatory architecture for cross-border/mutual recognition) above) or whether instead FSI Recommendation 42 is recommending that the Government look at *all* CAMAC's recommendations or consultation proposals relating to managed investment schemes, CAMAC issued two detailed and extensive reports relating to managed investment schemes, in 2012 (a Final Report) and 2014 (a Discussion Paper).

We deal *separately* below *specifically* with the reference in FSI Recommendation 42 to the regulation of illiquid schemes.

However, to the extent that FSI Recommendation 42 is in fact intended to be more extensive than (1) and (2), and is intended to recommend the Government review *all* CAMAC's recommendations on managed investment schemes then, for the reasons below we do not support this Recommendation. That is we do not support the need for a holistic review of managed investments regulation (including a review of all CAMAC recommendations relating to managed investments).

A comprehensive review of the regulation of managed investments is not warranted. Further, there were recommendations in CAMAC's 2012 report (for example) which impose unnecessary prescriptive requirements which are not necessary given current licensee/responsible entity duties and some of the CAMAC recommendations are unworkable. For example, CAMAC's 2012 recommendation that a separate AFS licence be held for the operation of each and every registered scheme if CAMAC's Separate Legal Entity proposal were not adopted (albeit predicated on the SLE Proposal not being adopted – we provide no comment on the SLE Proposal) would require some FSC members to hold over 100 separate AFS licences – obviously this CAMAC recommendation is impractical, highly inefficient and incredibly burdensome.

In summary, we <u>do not</u> support the need for a holistic review of managed investments regulation (including a holistic consideration of the CAMAC reports). That is not to suggest that some specific and isolated CAMAC recommendations may not be worthy of consideration (where they may result in more efficient regulation), however we do not support a holistic review of managed investments regulation.

RECOMMENDATION: A comprehensive review of the regulation of managed investments is not warranted. We do not support the need for a holistic review of managed investments regulation.

<u>Managed investments regulation – liquid and illiquid fund provisions</u>

The FSI recommends that Government review CAMAC's recommendations relating to managed investment schemes. In particular, the CAMAC report suggested changes to the illiquid fund provisions. Currently the Chapter 5C provisions provide for withdrawal offers to be made in circumstances where a fund is illiquid – such an approach is designed to manage unit holder equity and ensures fair and equal access to finite liquidity. The illiquid fund provisions in Chapter 5C were inserted in response to the property market collapse (and the impact on unlisted property funds) in the early 1990s.

The FSC does not have a position on particular refinements to Chapter 5C (including relating to illiquid funds) as we would need to see the detail of any consulted proposals to comment and compare any proposals to the current operation of the provisions.

We consider that if the Government was to consider a review of the operation of Chapter 5C Corporations Act as it relates to illiquid schemes, it is absolutely essential that consideration be given to the benefits or otherwise of the current operation of the Chapter 5C provisions and, if any changes were to be contemplated, the impact that any changes to the current provisions would have on existing product offerings and new product offerings.

The change/transition impacts of any changes to the Chapter 5C provisions relating to liquid and illiquid funds should not be underestimated in any consideration which may be made for reform in this area. Irrespective, FSC supports clear disclosure as to the nature of a fund, including its expected liquidity profile (whether it is expected to be liquid or illiquid), and ASIC has assisted in providing guidance in relation to certain asset classes and disclosure in relation to liquidity.

RECOMMENDATION:
If the Government considers it appropriate to review the illiquid fund provisions, the Government should extensively consult on any potential changes. This should include weighing up costs and benefits and carefully considering whether or not changes are necessary and appropriate, and if so, the impacts of any changes on new and existing funds.

FSI RECOMMENDATION 44:

Remove market ownership restrictions from the Corporations Act 2001 once the current reforms to cross-border regulation of financial market infrastructure are complete.

The FSC supports the removal of the market ownership restrictions from the Corporations Act 2001 and believe that this is a good policy change to make the ASX subject it to the same ownership restrictions as others in the financial sector.

The FSC is a supporter of deregulation, the removal of barriers in financial markets and an open economy. It is important though that all entities are subject to the same regulations and that there is a level playing field in opening up the market. Market integrity will be paramount in lowering barriers to entry.

Once the regulatory structures are in place for cross-border financial market infrastructure controls, the issue of foreign market ownership does not pose a significant risk, as it once did when the controls were put in place. It is essential that the financial architecture is robust before this occurs and we are confident it will be following the regulatory changes.

RECOMMENDATION:

Support the removal of market ownership restrictions from the Corporations Act 2001.

RECOMMENDATION 32:

Explore ways to facilitate development of the impact investment market and encourage innovation in funding social service delivery. Provide guidance to superannuation trustees on the appropriateness of impact investment. Support law reform to classify a private ancillary fund as a 'sophisticated' or 'professional' investor, where the founder of the fund meets those definitions.

Facilitating the development of an impact investing market would be a difficult task for Government. While the FSC supports this, we do not believe any impact investments should be mandated (in line with the sole purpose test under the SIS Act).

The investments in impact investing programs are inherently long term and carry a high level of risk, which would need to be carefully managed. The facilitation of this market would also require effective partnership between investors, Government and community organisations.

FSC supports measures to improve training of trustee directors but again, does not support any mandated investments or mandatory education standards (see Chapter 4: Superannuation).

The NSW Government has announced it will aim to facilitate a market in the state and had proposed four initial project areas. The Federal Government should see how this market develops in NSW and collaborate on potential viable projects.

The Federal Government should undertake a feasibility study and develop a strategy for the development of an impact investing market. This process should involve Australia's fund managers and superannuation funds to advise on the commercial realities of such investments. Further, lessons from investors in the UK in particular would assist in this process.

If executed correctly, using lessons from the UK and the US, this market could take a significant burden off the social service budget and develop more innovative social service delivery in Australia.

RECOMMENDATION:

FSC supports development of a feasibility study and strategy for impact investing but does not support mandating investments or education standards.

FSI RECOMMENDATION 33

Reduce disclosure requirements for large listed corporates issuing 'simple' bonds and encourage industry to develop standard terms for 'simple' bonds.

FSC is supportive of deregulation and the simplification of disclosure requirements generally and anything that broadens the corporate bond buying audience in Australia is a positive. However, the current disclosure requirements are not necessarily the impediment for corporates to issue simple bonds. The Government should undertake research to determine the impediments that may be restricting the development of a corporate bond market.

There are some important points to consider before reducing disclosure for corporate bonds. These products are complex and investors may not be aware of the risks involved. Reducing disclosure could heighten this risk as well as increase risk for corporates in the event of investors suffering significant losses.

Points to consider:

- High complexity: investors are not sufficiently aware of the risks they are assuming due to the high complexity of existing retail bonds – this may warrant higher levels of disclosure, not reduced.
- No credit ratings: the willingness of ratings agencies to apply ratings to retail bonds would be a strong positive for the market to gain traction. However for legal liability reasons the agencies are currently not willing to do so. This has proven problematic for retail investors buying retail bonds.
- ASX 150 already issue retail bonds: It is not the focus on the quality of the issuer, rather the structural complexity and rights held in the retail bonds that are so critical.
- Heightened reputational risk: reduced disclosure increases reputational risks where retail investors suffer significant losses where they had not understood the product.

RECOMMENDATION:

The Government should remove the current impediments to corporates issuing bonds. If disclosure is seen as the largest impediment, costs and benefits should be carefully considered before a change to requirements.

CHAPTER 3: LIFE INSURANCE

This chapter contains responses to the FSI's recommendations on life insurance.

FSI RECOMMENDATION 19:

Review the costs and benefits of increasing access to and improving the use of data, taking into account community concerns about appropriate privacy protections.

Better management of government data presents great opportunities for the private sector and consumers, including allowing more tailored products and services. The FSC believes that insurers are particularly well positioned to develop better products for consumers on the basis of better capitalising on data.

Data sharing between Government and the private sector, and data analytics, will be crucial to the next wave of innovation in the sector. For example, better collation and management of health data would allow life insurers to offer more personalised, risk-weighted products.

In turn, greater up-take of insurance products would help relieve underinsurance and the strain on Australia's welfare system – a system which will come under increasing budgetary stress owing to our rapidly ageing population.

RECOMMENDATION:

The FSC strongly supports the recommendation that the Productivity Commission commence an inquiry into the benefits of improved data sharing. The FSC is confident that privacy and security concerns can be carefully managed so as to allow the Government and private sector to access a valuable, untapped resource.

FSI RECOMMENDATION 24:

Better align the interests of financial firms with those of consumers by raising industry standards, enhancing the power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice.

Consumer trust and confidence in financial advice and life insurance products must be strengthened to ensure Australians are protected by sufficient life insurance cover. Ensuring Australian consumers have access to quality life insurance advice and life insurance frameworks which place consumer interests first is imperative.

The FSC has been an active participant in the 'Trowbridge Review' and has made a submission to the Interim Report which makes a number of recommendations to improve consumer outcomes and address industry issues.

Our recommendations included:

1. the proposed remuneration model (which has been developed solely for the purpose of responding to the interim Trowbridge report) be adopted by and implemented by the industry through a self regulatory mechanism, following ACCC authorisation or through legislation if a self regulatory mechanism is not feasible;
2. that the FSC establish a working group to develop a life insurance code of practice;
3. following consultation on how Statements of Advice (SoA) could be streamlined to better meet the spirit of the law, ASIC should work with industry to develop a streamlined SoA; and
4. ASIC provide further regulatory guidance and practical examples on how the best interest duty can be met in the provision of life insurance advice.

The industry continues to support the independent process and the Life Insurance and Advice Working Group has made considerable progress in addressing the concerns raised by ASIC's Review of Retail Life Insurance and Advice report.

In fact, the Trowbridge Review has canvassed a wider range of issues than initially raised by ASIC and the FSI, specifically how best to deal with the misaligned incentives which high up-front commissions pose. The industry will absorb the recommendations of the Final Report when it is released and review them with a view towards developing a response that takes the recommendations and consumers' best interests into account.

A full copy of the FSC submission to the 'Trowbridge Review' Interim Report has been attached to this submission (see Appendix A).

RECOMMENDATION: The FSC submits that the Parliament continue its support for the independent process, led by independent Chairman John Trowbridge, which has recently concluded.

FSI RECOMMENDATION 41:

Define bank accounts and life insurance policies as unclaimed monies only if they are inactive for seven years.

The present regulatory environment for unclaimed monies was changed in 2012 from a longstanding arrangement that required an inactive period of seven years.

While this will bring about an improvement, there are a range of other unclaimed bank account and life insurance money provisions that require review. The FSC prepared a submission for Treasury in July 2014 outlining the differences in the types of life insurance products regulated through these provisions. The submission made recommendations to:

1. Align 'superannuation' business arrangements with the superannuation unclaimed money legislation; and

   Consult further with the industry on necessary Life Act amendments to ensure the legislation proclivities offer flexibility for the types of policies impacted by the provisions and ensure a consistent, efficient approach to the management of unclaimed moneys.

Under the existing arrangements, all unclaimed money in relation to life policies is dealt with under section 216 of the Life Insurance Act 1995 (Life Act). This provision requires the payment of the amounts payable to ASIC on behalf of the Commonwealth.

However, unclaimed moneys in relation to life insurance policies in Australia can be divided into two types of business – *ordinary business* or *superannuation businesses*. We submit that there should be two different solutions with respect to unclaimed moneys reflecting the different nature of each business:

1. *Ordinary Business*

   The FSC recommends the unclaimed money provisions in relation to the process for reuniting a consumer with their policy proceeds be amended to be administered in a manner consistent with lost superannuation arrangements to allow either:

   a. the insurer to retain the funds and simply report the ‘lost policyholder’ to ASIC for publication on the register; or
   b. where amounts have been paid to ASIC, if/when the policyholder is located and the funds become repayable to the consumer, the payment should be made directly by ASIC.

2. *Superannuation Business*

The FSC recommends the Government consult with the life insurance industry to implement amendments to the Life Act and the Superannuation (Unclaimed Money and Lost Members) Act and Regulations to treat lost and unclaimed life insurance policies that are 'superannuation business' in a manner consistent with other lost superannuation arrangements.

RECOMMENDATION:

The FSC supports the recommendation that bank accounts and life insurance policies should be classified as unclaimed monies only if they are inactive for seven years. In addition, the FSC submits that the current arrangements in relation to the unclaimed life insurance money provisions create unnecessary complexity, are inefficient and do not achieve the stated objective of balancing the protection of the value of the account holder's funds with effectively reuniting account holders with their money.

FSI RECOMMENDATION 43:

Introduce a mechanism to facilitate the rationalisation of legacy products in the life insurance and managed investment sectors.

A comprehensive product rationalisation regime would provide better consumer outcomes by creating greater efficiency in the industry and access to more modern and relevant offers for consumers. Indeed, the current mechanism for rationalising managed investment schemes, life insurance legacy products and other related products or structures is too difficult and expensive. As a result consumers remain in financial products that suffer from a higher cost base and carry operational risk from outdated technology and products that are difficult to support.

A comprehensive proposal for product rationalisation was first put to Government by the FSC in July 2005. That submission was followed in May 2006 with a regulation impact statement also prepared by the FSC. Unfortunately, the problem still exists and has resulted in the creation of over 600 legacy structures amongst FSC members, each of which may contain multiple products, affecting an estimated 2.44 million consumers.

The FSC surveyed members to develop conservative estimates of the benefits that an effective product rationalisation regime would deliver in the near term:

- 38 individual IT systems could be closed, of 79 legacy IT systems across the sample;

- 286 life products and 77 managed investment schemes could be closed; and
- $22.6 billion in funds under management could be transferred to contemporary products.

FSC members forecast that through these changes they could achieve $94 million in cost reductions over the near term through a staged rationalisation program, which would result in a more efficient and sustainable industry.

Although a financial product may be closed and is of low scale, it still needs a broad range of services similar to those provided to an on-sale product, including technology, accounting, audit, disclosure, legal, actuarial, product and tax services as well as being supported by an administration team and front line call centre staff who need to be trained on the particular product.

Continuing to manage bespoke financial products that are highly aged and whose promotion predates the majority of employees' tenure is a significant challenge for most financial services companies. This is both from an operational risk perspective but also in maintaining aged systems that are typically less agile or economical to run and keep updated (including for regulatory change), less able to support a modern service to customers and more challenging to locate appropriately skilled support staff.

For example, while each product within a particular group shares certain characteristics, there are typically individual differences which must be monitored to ensure promises made to customers are met and this layering of iterative legacy product complexity is a material compliance burden, a barrier to organisational change and diverts resources from more customer value added activity.

If the problem isn't fixed, providers will not be able to rationalise products in the overall interests of consumers. It is going to become increasingly risky and expensive to administer products. Consumers would become worse off due to increasing costs (exacerbating underinsurance) and reduced service, and also run the risk of being trapped in out of date products – products which may have become obsolete as a result of changing tax, legal and social security regimes and also shifts in consumer sentiment and demand.

Furthermore, it is hard for product issuers to justify investment in new tools for legacy products and other enhancements beyond what is legally required. Because of this consumers of legacy products lose out on that upside benefit. For example, a legacy product will not typically offer online access and other digital features that are being built into new products.

Product rationalisation in superannuation

The current rationalisation regime in superannuation works well from a consumer and product issuer perspective and has been used considerably by the industry in recent years to the benefit of all industry stakeholders.

The central thrust of the regime is that a consumer can be transferred to another product, or have their existing product changed, broadly if the Trustee determines it to be in the interests of those consumers.

On a transfer between products, the precise nature of the test is determined by whether the customer is moving:

- between different super funds (called a successor fund transfer or SFT); or
- to another product within the same super fund (known as an intra-fund transfer or IFT).

In both cases, if the bundle of rights consumers enjoy in the current product can be met by an alternative product that passes the consumer interest test, the trustee may approve the transfer without consumer consent. The key difference is that for a SFT, the test is undertaken at an individual consumer level, versus as a group of consumers for an IFT. In both cases, if the bundle of rights consumers enjoy in the current product is equivalent (for SFTs) or bettered (for IFTs) in the new product, the trustee may approve the transfer without consumer consent.

Our view is that the rationalisation regime for other product types should be modelled on that for super, with the exception that the relevant test be undertaken at the collective consumer level in all cases to improve stakeholder outcomes. To do otherwise could prevent some rationalisations that are in the interests of the majority from going ahead because of a minority impact

FSC proposal

The FSC's proposed product rationalisation mechanism leverages that of superannuation and is focused on consumer protection and industry efficiency. The proposal outlined in the attached submission ensures that:

- Consumer rights are protected through the requirement for the product issuer to ensure the change is in the interests of consumers.
- A consumer interest test is applied at the collective level, rather than the individual level to enable the maximum number of consumers and other stakeholders to benefit, driving overall industry efficiency.

The proposed product rationalisation framework would result in improved disclosure, lower operational risk and access to more relevant and modern product solutions for consumers. It would also promote competition and productivity within the industry and reduce costs for industry participants.

The FSC proposes a common rationalisation regime that can be applied to the following product types or structures:

- Life insurance products (risk and investment)
- Managed Investment Schemes and Investor Directed Portfolio Services
- Underlying investment structures, including deferred annuities

Common rationalisation mechanism

A consistent approach to rationalising legacy products is an achievable outcome and is desirable for financial product providers. The FSC proposes that a standardised consumer interest test would apply across financial products, but excluding superannuation which has an existing rationalisation mechanism.

Consumer interest test

The aim of a financial product provider in rationalising legacy products is to remove economically inefficient or out-dated products and to elicit a fair outcome for consumers.

To achieve that outcome for consumers, the FSC proposes that a consumer interest test apply at group or class level to assess whether a financial product or group of products can be rationalised.

As in Part 9 of the Life Insurance Act 1995 and successor fund transfer processes of Part 18 of the Superannuation Industry (Supervision) Act 1993, the consumer interest test should be:

- Based on the monetary benefits and rights enjoyed by the consumer as at the Transition Date (rather than intangible product features, unless these represent a monetary benefit or right);
- Determined as the accrued value of those benefits;
- Calculated by an independent expert or the Appointed Actuary; and
- Based on the overall bundle of rights consumers have and not at the individual feature level.

Tax implications and relief requirements

There is a range of tax implications that flow from activities designed to rationalise legacy products. As a general rule the FSC's position is that the tax attributes of the original vehicle should be able to roll over to the destination vehicle.

This document is intended to be a high-level principles based approach to the issues and there will ultimately be further consultation required to refine some aspects of the proposed approach. We would be pleased to provide further input into this process on specific drafting points and also in relation to expanding upon the taxation and relief elements in more detail.

Appendix B to this submission outlines the FSC's rationale and proposal for product rationalisation in the following areas:

- Financial product rationalisation scenarios; and
- Application of rationalisation mechanism for different product types.

The proposed product rationalisation framework would result in improved disclosure, lower operational risk and access to more relevant and modern product solutions for consumers. It would also promote competition and productivity within the industry and reduce costs for industry participants.

RECOMMENDATION:

The FSC proposes a common rationalisation regime that can be applied to the following product types or structures:

- life insurance products (risk and investment);
- managed investment schemes and investor directed portfolio services; and
- underlying investment structures.

The FSC's proposed mechanism is outlined in Appendix B.

Inefficient State Taxes

FSI Appendix 2: Tax summary states the following:

> "Insurance taxes mean that individuals and businesses must pay more to achieve the same risk reduction. Reducing duties on insurance would assist in dealing with underinsurance."

The treatment of stamp duty on life insurance is an example where consumers must pay more to achieve the same risk reduction. In the case of stamp duty on life insurance, this is further complicated because:

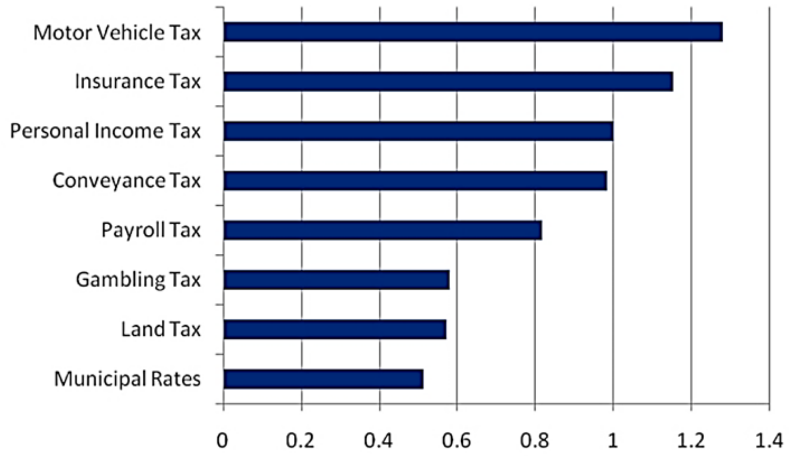
- each jurisdiction has a different regime for the collection of stamp duty on life insurance policies.
- individual members of different group insurance products residing in different States must be accounted for by insurers when calculating each member's stamp duty liability, thus creating a substantial and costly administrative burden.
- each jurisdiction applies different stamp duty rates to life insurance 'policy riders', such as such as trauma and disability cover, despite the fact it is virtually impossible to purchase these 'policy riders' as a stand alone product.
- the cost to collect the tax (cost to insurers and government) in most jurisdictions would comprehensively exceed taxes raised.

Each State and territory has a different rate and basis for levying taxes collected. Some are sum insured based; some are premium based; some have a combination; some have no duty on life insurance but loaded duties on rider benefits; the percentage of rates levied on life rider benefits vary from state to state and product to product.

This creates a productivity drag on life insurers because it necessitates complex assessment processes, legal fees and systems reconfiguration all of which would be simplified under a harmonised system, or not necessary at all if stamp duty was abolished. Previous studies have shown that the compliance cost exceeds revenue collected by government.

According to research by Deloitte Access Economics for the Finance Industry Council of Australia, insurance taxes rank as the second most inefficient of taxes levied by State governments (see Table 4).

Table 4: General efficiency rankings of State/Federal taxes



Attempts to have a 'uniform' methodology for the raising of the state tax have failed on a number of occasions and Australia is one of the few mature economies that taxes life insurance and life riders instead of giving a tax deduction.

RECOMMENDATION:

The FSC believes that inefficient stamp duties applying to life insurance products contribute toward underinsurance and should be abolished. This will be a core component of the FSC's response to the Federal Government's Tax White Paper and Federation White Paper in 2015.

To the extent that changes are made to Australia's taxation system, we encourage the Commonwealth to ensure the States commit to their promise to abolish inefficient taxes. Importantly this commitment should be a focus of any agreement to make changes to the GST.

Backtracking of States on prior commitments has resulted in a patchwork of inefficient, distortionary tax outcomes. These are in turn impacting on areas of the economy with undesirable consequences.

CHAPTER 4: SUPERANNUATION

This chapter responds to the FSI's recommendation on superannuation and retirement policy.

FSI RECOMMENDATION 8:

Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds.

The FSC interprets this recommendation as primarily relating to direct borrowing arrangements within Self-Managed Superannuation Funds (SMSF).

The FSC is concerned, however, that the recommendation could also be construed as applying to investments by APRA-regulated superannuation funds into unit trusts that either contain gearing or invest in corporate entities, such as ASX listed companies, that are geared. The FSC makes submissions in relation to this issue for completeness in spite of it appearing that the recommendation was not intended to apply to these arrangements.

The FSC opposes a prohibition on gearing that would effect investments in unit trusts that contain gearing or investments in geared corporate entities. Such a prohibition would be inconsistent with the policy intent of the recommendation as it is not the superannuation trustee that arranges the loan, or is liable for the loan, but the trustee of the unit trust.

There are two methods within which a consumer can be exposed to gearing in this context:

1. If the superannuation trustee decides to invest in a geared unit trust as part of a broader investment strategy across multiple asset classes, which would significantly dilute the consumer's exposure to the debt; and/or
2. If the consumer decides to invest in the geared unit trust or buy direct equities in a geared corporation through a platform, in which case the consumer is more likely to be a sophisticated consumer or acting under financial advice.

The FSC submits that it is appropriate to allow for unit trusts to continue containing gearing as the exposure to debt occurs within the prudential oversight of APRA and is disclosed to consumers through the Product Disclosure Statement (PDS).

The FSC submits that, in contemplating any prohibition of gearing, the Government recognise:

- the significant reduction in exposure to Australian and International equities should investments in geared corporate entities be banned;
- the low levels of risk arising where a unit trust is geared under the prudential oversight of APRA; and
- the low level of risk arising where a unit trust is subject to the PDS regime and discloses its gearing to financial advisers and consumers.

It is also relevant to note that the cost of gearing is lower in wholesale unit trusts than retail products, for instance direct residential property. Such products are also not subject to margin calls. This further reduces the risk exposure of the APRA regulated superannuation funds to gearing inside unit trusts.

RECOMMENDATION: The FSC recommends that borrowing within APRA regulated superannuation funds not be affected by this review and that the FSI recommendation be solely confined to SMSFs, as was intended by the FSI final report.

<u>FSI RECOMMENDATION 9:</u>

<u>Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the long term.</u>

The FSC supports the Government seeking broad political agreement around the objectives of the superannuation system and enshrining these objectives in legislation.

The FSC submits that the objective of the superannuation system is to provide adequate retirement incomes for Australians in order to:

1. improve their quality of life in retirement; and
2. reduce their reliance on the age pension and other age related transfer payments to minimise the fiscal impact of retirement.

The FSC also recognises that the superannuation system has resulted in as much as $1 trillion in additional national savings than would otherwise have been achieved without a compulsory system.[5]

[5] *Funding Australia*, Industry Super Australia, March 2014

The FSC submits that this is a beneficial consequence of the system rather than an objective in its own right.

Due to the long-term policy intent of the superannuation system it is critical that the objective of the superannuation system be enshrined in legislation and based on bipartisan support. Agreed objectives can then become a reference point for testing any further reforms to the system.

RECOMMENDATION:

The FSC recommends that the Intergenerational Report (IGR) becomes the evidentiary basis for the measurement of the effectiveness of the superannuation system and examination of proposed reforms to the system. The natural relationship between the IGR, which examines the Government's fiscal position forty years into the future, and the superannuation system, which is intended to address the intergenerational cost of an ageing population, is clear.

RECOMMENDATION:

The FSC recommends the relationship between the IGR and measuring and reforming the superannuation system receive broader political support.

Analysis of the performance of the superannuation system against the fiscal challenges identified in the IGR, however, shows that our $2 trillion pool of national savings is serving Australians retirees well. $74.5 billion is being paid in retirement benefits each year, raising the quality of life of Australia's retired population.[6]

These retirement benefits are significantly more than the $39.5 billion cost of the age pension in 2013-14 and, as examined by NATSEM in modelling for the FSC, age pension outlays are currently reduced by $5.7 billion per annum.[7] Continuing to dedicate the superannuation system to providing retirement incomes will further reduce age pension outlays by $11.1 billion per annum by 2030.[8]

The FSC does not support setting specific performance targets for the superannuation system. The changing demographic profile of Australia and unpredictable variables, such as volatility on global markets, makes such performance targets inherently inaccurate and misleading to the public.

[6] APRA, 2013

[7] NATSEM 2014

[8] NATSEM 2014

FSI RECOMMENDATION 10:

Introduce a formal competitive process to allocate new default fund members to MySuper products, unless a review by 2020 concludes that the Stronger Super reforms have been effective in significantly improving competition and efficiency in the superannuation system.

The FSC agrees with the overarching principle that competition is necessary to drive better consumer outcomes, including lower fees and higher net returns. This is consistent with the original policy intent behind MySuper, which was to create comparable default products between which consumers could exercise choice. Reform of the superannuation system to introduce greater competition, however, should begin with allowing all MySuper products to compete for contributions by removing regulatory barriers to competition inherent in the modern award system and enterprise agreements.

Competition in the default market, along with the implementation of MySuper, should be afforded sufficient time to bring fees down and boost member returns. The FSC is not opposed to a review of the superannuation system, as broadly outlined in our response to FSI Recommendation 9. The FSC submits, however, that a review as soon as 2020 may be premature and that the 2020 IGR should assess the effectiveness of the superannuation system in achieving its policy objectives before the review, conceptualised in the FSI report, be committed to.

MySuper has contributed to the reduction in fees in the retail superannuation market. Average MySuper asset fees amongst FSC members have fallen from 1.61 per cent in 2011 to 0.82 per cent in 2013.[9] Industry wide the average MySuper fee is 0.85 per cent. MySuper has also resulted in many retail funds becoming more competitive in both fee charges and returns generated than industry funds.

Extracting the greatest benefits from MySuper, however, can only be fully achieved if all MySuper products are able to compete for default superannuation contributions.

The current default system prevents consumers and employers from choosing to leave an underperforming MySuper product in order to join a more competitive product, a critical ingredient in allowing MySuper to bring down fees in the system.

[9] RiceWarner, Superannuation Fees Report, 2014

Top performing retail MySuper products, including pure play retail funds not owned by banks, are not included in modern awards and employers are unable to choose those funds to be the default fund for their workplace.

Further, none of the top performing retail funds would be named in any enterprise agreements. Agreements are negotiated by unions and employers, and typically name the MySuper product offered by industry funds, which are owned by the same union participating in the negotiations. This places consumers at risk where industry funds are chosen for default status because they are supported by the union, regardless of the performance of that fund.

Reform is therefore necessary to both the modern award system and enterprise agreements to allow competition before the effectiveness of the MySuper reforms can be reviewed.

RECOMMENDATION:

The FSC recommends the Government open the default superannuation market to competition by allowing any APRA approved MySuper product to compete to become the default fund for any workplace. This requires the Government to remove superannuation from the modern award system and allow all employees covered by enterprise agreements to exercise choice of fund.

On this basis the FSC supports a review of the performance of the superannuation system in 2020 as part of the IGR process, after a period of open competition. A subsequent review, in line with that recommended in the FSI Final Report, could be conducted after 2020 should provide an evidentiary basis that demonstrates that the superannuation system is achieving its objectives.

The current default process severely limits competition between funds. The current process:

- creates unnecessary duplication by requiring MySuper products to be approved by APRA, then accepted for default listing by the Fair Work Commission (FWC) Expert Panel and then chosen from the list by the FWC Full Bench; and
- favours incumbent award default funds by restricting the right to make submissions in the second stage of the FWC review, which decides which fund is listed in each award, to only registered organisations (unions and employer organisations) that own industry funds.

The Productivity Commission review of the FWC's role in the default superannuation market led it to note that "the selection of default funds in awards largely reflects precedent and is not subject to a competitive process."

The current FWC process fails to address the concerns of the Productivity Commission by only allowing unions and employers, who own industry funds, to make submissions in relation to which funds are listed in each modern award. The FWC system is both conflicted and not transparent and must be abolished in favour of competition.

Research by Rafe Consulting has demonstrated that, should the current FWC process be completed, 2.25 million fund members could have their superannuation contributions moved to a new fund should the FWC review process be allowed to be completed. This would result in duplication of accounts, multiple fees and insurance premiums, and increases in 'lost' super.[10]

Rafe Consulting estimates that the total cost to superannuation funds, fund members, employers and the Government could exceed $400 million should the FWC default superannuation review be allowed to conclude.

FSI RECOMMENDATION 11:

Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way.

The FSC supports this recommendation as the superannuation system does not currently address the needs of Australians at retirement.

The default arrangement is for a retiree to remain in accumulation phase for an unnecessarily long period of time until they decide how to structure their retirement. A large number of retirees do not receive advice at retirement and are at risk of making poor financial decisions.

The ramifications of a poor decision at retirement can significantly undermine the quality of an individual's retirement and undermine the effectiveness of the significant tax concessions afforded superannuation.

There is also limited diversity in retirement products to cater to the needs of Australians. This may be because the retirement phase has not been subject to the same level of analysis as the accumulation phase. As a result the policy framework is less sophisticated.

[10] Rafe Consulting, Impact of the Changes to the Fair Work Act on the Australia superannuation sector, employers and their employees, June 2014

The FSC understands that the following principles are consistent with the FSI's recommendations and should form the basis for reform of the retirement market:

- Trustees be allowed to build into MySuper products a seamless transition into retirement phase where members who do not exercise choice at retirement are moved into a retirement product after they have notified the fund that they have retired;
- that retirement product may include an annuity, including annuity premiums paid in instalments in lieu of life insurance, an allocated pension, or a combination of an annuity and allocated pension;
- Trustees offering Choice products would have the capacity to choose whether to have the retirement phase 'built in' to their choice products, or require members to seek advice from their advisor or fund (or not) at retirement; and
- a broad degree of flexibility be afforded the retirement market so that a range of products become available to accommodate different retirement needs (with members protected by a trustees duty to move the members into a product that is in their best interest).

The FSC also supports Government moves to reform the retirement system to allow a more diverse income stream market to develop subject to appropriate APRA oversight and ongoing prudential regulation.

The FSC submits that these parameters would allow a well functioning retirement system to develop quickly, but still allow individuals to tailor their financial arrangements to suit their personal needs. The point at which an individual contacts the fund to notify the fund of their retirement allows a point of engagement where the fund, or a financial advisor, can allow the individual to make improved retirement decisions for their situation.

The proposed framework would also allow the annuity market to achieve scale in Australia through group purchasing of annuities. Group annuitisation is important to minimise risk associated with selection bias from differing life expectancies.

RECOMMENDATION:
FSC supports the recommendation which would require a trustee to pre select a retirement option for their membership.

FSI RECOMMENDATION 12:

Provide all employees with the ability to choose the fund into which their Superannuation Guarantee contributions are paid.

The FSC supports this recommendation. Current legislation enables enterprise agreements to remove an employee's right to choose their own superannuation fund. In a mandatory system it is unacceptable that employees can be prevented from choosing the custodian of their retirement savings.

There are also conflicts of interest between who is responsible for negotiating enterprise agreements and the owners of industry funds. The unions and employers that negotiate agreements own industry funds and often receive financial compensation, including directors fees and opaque 'sponsorship arrangements', from those funds.

Unions and employers are incentivised to name the superannuation fund they own and receive payments from these funds, in the enterprise agreement they are negotiating. This may leave consumers worse off where the consumer is forced to make their contributions to a poorly performing fund named in an enterprise agreement.

RECOMMENDATION:

The FSC supports the recommendation to allow all Australians to select a superannuation fund.

FSI RECOMMENDATION 13:

Mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements.

Our earlier comments in the life insurance chapter relate to the structure of the life insurance sector. The following relates to superannuation.

The FSC submits that all superannuation funds, including both retail and industry funds, should be required to have a majority independent directors and an independent chair. In our mandatory superannuation system this would establish the highest level of governance and consumer protection.

Superannuation legislation, however, currently does not require superannuation funds to have independent directors on their boards. The *Superannuation Industry (Supervision) Act 1993 (SIS Act)* currently allows for a sole independent director on equal representation boards if:

- an employer or employee sponsor has requested an independent director;
- the governing rules of the fund allow for an independent director; and
- the independent director is not allowed to make a casting vote.[11]

Appointing more than one independent director on equal representation boards requires the fund to apply for an exemption to the SIS Act.

The Financial Services Council (FSC) Standard 20 requires members who are public offer retail superannuation funds to have a majority independent directors and an independent chair. Not all retail superannuation funds, however, are members of the FSC and not all retail funds have independent directors.

Independent directors add value to corporate boards. Independent directors have a fiduciary duty to all of the members of a superannuation fund or shareholders of a corporation that is not weakened by the existence of a relationship with a related party.

By definition independent directors are free of the types of conflicts that may cause them to deliberately or unconsciously serve the interests of a related party or a subset of members, rather than the fund's entire membership.

Independent directors of superannuation funds would be free from the influence of:

- a parent company, such as an insurance company or bank;
- a sponsoring organisation, such as a union or employer organisation;
- a service provider, such as an administrator; and
- a subset of the membership, such as those fund members who are also a member of the sponsoring union.

Definitions of independence

There are different standards of independence that relate to directors of corporate boards and superannuation fund boards:

[11] Section 89(2) of the SIS Act

- APRA's Prudential Standard CPS 510 for deposit-taking and insurance sectors;
- The *Superannuation Industry (Supervision) Act 1993* (SIS Act);
- FSC Standard 20; and
- ASX Corporate Governance Principles.

An important difference is whether someone is considered independent when they have a relationship with a related party, such as a bank, union or employer organisation.

The SIS Act has the least rigorous definition of independent. The SIS Act narrowly defines independence as:

- not a member of the fund;
- neither an employer-sponsor of the fund nor an associate of such an employer-sponsor, or an employee of either a representative organisation or an employer-sponsor; and
- not, in any capacity, a representative of a trade union representing the interests of one or more members of the fund.[12]

The SIS Act currently allows individuals with a material relationship to a parent company, service provider, employer-sponsor or union to be classified as an independent director.

APRA's standard for banks and insurers is a relevant reference point for superannuation funds, as are the ASX Corporate Governance Principles that relate to corporations.

APRA Standard CPS 510, which applies to non-superannuation businesses, defines independence as:

> "A nonexecutive director who is free from any business or other association – including those arising out of a substantial shareholding, involvement in past management or as a supplier, customer or adviser – that could materially interfere with the exercise of their independent judgement.[13]"

The ASX Corporate Governance Principles define an independent director as being:

> "Free of any interest, position, association or relationship that might influence, or reasonably be perceived to influence, in a material respect his or her capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity and its security holders generally.[14] "

[12] Section 10 of the SIS Act
[13] Prudential Standard APS 510 at Para 25
[14] ASX Corporate Governance Principles at page 16

The FSC recommends that superannuation funds should be held to the same standards as ASX listed companies and other APRA regulated sectors. The FSC notes recent comments by APRA Member Helen Rowell on 19 February 2015:

> "Compared to the other industries APRA regulates, the superannuation sector has a bit of catching up to do on its governance standards. APRA's observation is that industries with a majority of independent directors tend to have a broader skill set that leads to better governance," Ms Rowell said.[15]"

The definition of independence in FSC Standard 20 is a combination of the ASX Principles and APRA Standard CPS 510. The combination of these definitions was intended to create the strongest possible test of independence.

The FSC Standard 20 definition of independence prevents those with material third party relationships from being deemed independent. This strong definition of independence is important to protect the integrity of our mandatory superannuation system.

The FSC Standard prevents a director from being independent if they are employed by the fund or a related body corporate or have a material interest in one of those bodies (such as a bank or insurer in a conglomerate structure).

The Standard also precludes those employed by a related party or a company that is a material service provider, or have held such a position in the last three years.[16]

Proportion of independent directors

The FSI recommended in 2014 that all superannuation trustee boards, including both industry funds and retail funds, should be required to have a majority of independent directors. The FSI drew on overseas research that suggests that "good governance adds one percentage point to pension fund returns." [17]

The FSI concluded that:

> "Including independent directors on boards is consistent with international best practice on corporate governance. Independent directors improve decision making by bringing an objective perspective to issues the board considers. They also hold

[15] *Keep super for retirement APRA exec*, Financial Review, 20 February 2015

[16] FSC Standard 20

[17] Financial System Inquiry Final Report, Chapter Two; Governance of Superannuation Funds

other directors accountable for their conduct, particularly in relation to conflicts of interest."

The rationale for allowing industry funds to have different board composition from other corporate entities argued that equal representation was a historical relic of our system that stemmed from the defined benefit and industrial origins of our superannuation system. There is not a strong case for ongoing special treatment of superannuation funds if the result was weaker standards of governance in the context of a mandatory $2 trillion superannuation system.

As more fund members exercise choice, directors appointed by employer and employee groups are less likely to represent the broader membership of public offer. Given the diversity of fund membership, it is more important for directors to be independent, skilled and accountable. [18]

The FSI also demonstrated why the proposal to appoint only one third independent directors on equal representation boards was inadequate and inconsistent with best standards of governance. It concluded that "if independent directors are to have an effective influence on board decisions, all superannuation funds need a majority of independent directors."[19]

All APRA regulated sectors except for superannuation funds are required to have a majority independent directors and an independent chair under APRA Standard CPS 510. CPS 510 "sets out minimum foundations for good governance of an APRA-regulated institution in the deposit-taking, general insurance and life insurance industries."[20]

The FSC requires its members to comply with FSC Standard No. 20 Superannuation Governance Policy (FSC Standard 20). FSC Standard 20 requires members who operate a public offer superannuation fund to have majority independent directors and an independent chair. The FSC Standard is consistent with the recommendations of the Financial System Inquiry, Cooper Review and APRA's requirements for non-superannuation financial corporations.

Director penalty regime

The FSC supports raising standards of governance in the superannuation industry. We note, however, that aligning the director penalty regime with managed investment schemes may be problematic and undesirable.

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[18] Financial System Inquiry Final Report, Chapter Two; Governance of Superannuation Funds
[19] Financial System Inquiry Final Report, Chapter Two; Governance of Superannuation Funds
[20] Prudential Standard CPS 510 at 6-7

Directors of superannuation trustees are currently subject to distinct duties under both superannuation legislation and APRA standards that do not apply to directors of Managed Investment Schemes.

The differences between superannuation funds and MISs include:

- there are a limited number of superannuation funds that are already prudentially regulated by APRA. Managed Investment Schemes, by comparison, are not regulated by APRA and there is a much larger population of schemes in existence;
- Directors of superannuation funds are already subject to fitness and propriety requirements; and
- Directors of Managed Investment Schemes do not owe duties directly to unitholders, however directors of superannuation funds are liable directly to members.

The FSI also urges the Government to consider applying the MIS Director Penalty Regime to Life Insurance Company Directors. Director liabilities for life insurance companies are outlined in the Life Insurance Act. The Act includes provisions that make a director liable to pay the company an amount equal to any loss incurred as a result of a contravention of director duties (civil penalty). It is unclear whether there are any specific life insurance director breaches that the FSI recommendation is addressing, however it is important to note that life insurance directors already face more onerous make good liabilities than directors in a superannuation context, which is the direct focus of the recommendation.

It would be an inelegant solution if the MIS regime was imposed for life insurance directors, particularly because of the likelihood of a derivative liability for a director on the basis of a decision which was made some time before the current director's tenure. Furthermore, it is unclear whether the FSI Panel proposes that the existing civil liabilities for life insurance directors apply in addition to the civil and criminal liabilities under the managed investment scheme regime.

It is also not apparent why, in pursuing consistency with the MIS director liability regime, the FSI Panel have chosen not to propose standardisation of the relevant legislation for general insurers.

While the FSI Panel has recommended that the Federal Government *consider* the MIS regime for Life Insurance directors, it is the FSC's position that the interests of policy holders are amply protected under the Life Insurance Act, which establishes a directors' duty with respect to ensuring benefit expectations and security of entitlement. The FSC submits that life company directors already face significant indemnity for making good losses.

The provisions of the Life Insurance Act and other regulatory mechanisms outline how policy holders can be protected in terms of ensuring capital and solvency arrangements are met. ASIC has oversight of these requirements and is in a position to supervise and redefine these standards in order to ensure that policy holders are protected. This is especially true when decisions made today are backed by LPS320 and the appointed actuary, where there is an onus for the life company to actively manage the portfolio and change settings to react.

RECOMMENDATION:
FSC recommends a majority of independent directors be required on superannuation boards with a robust test of independence.

RECOMMENDATION:
The FSC submits that life company directors already face significant indemnity for making good losses. It is not appropriate that liabilities for life insurance company directors be aligned with the managed investment scheme regime.

<u>FSI RECOMMENDATION 37:</u>

<u>Publish retirement income projections on member statements from defined contribution superannuation schemes using ASIC regulatory guidance. Facilitate access to consolidated superannuation information from the ATO to use with ASIC's and superannuation funds' retirement income projection calculators.</u>

The FSC supports the recommendation that retirement savings be portrayed as income projections, rather than lump sums, on member statements. We note, however, that the publication of retirement income projections would require reform to ASIC's regulation of how these projections are calculated. The FSC recommends that the Government direct ASIC to commence consultation on how these calculations are conducted.

It would be necessary to undertake further consultation between industry, the Australian Tax Office (ATO) and the Government in relation to the use of consolidated super info from the ATO for this purpose. Much of the information captured by the ATO is commercially sensitive. The FSC supports examining how this can be achieved and how the use of consistent data can result in common calculation methodology of retirement income projections across the industry.

Publication of income projection would help achieve the overarching objective of orientating public perception of superannuation as providing an income in retirement, and better align the system with the objectives outlined in our recommendation to FSI recommendation 11.

RECOMMENDATION:
The FSC supports a shift in perception that superannuation is intended to provide retirement income. It is necessary to undertake further consultation with ASIC and the ATO to manage the regulatory implications and commercial nature of the data being used for these purposes.

CHAPTER 5: REGULATORY SETTINGS

The Final Report made nine relevant recommendations in relation to the overall regulatory system. The FSC's response to each of those recommendations is set out below.

FSI RECOMMENDATION 21:

Introduce a targeted and principles-based product design and distribution obligation.

A proposed obligation would apply to both product manufacturers and distributors, and require compliance at various stages of the product life cycle, including after the point of sale.

The FSC has concerns that such an obligation will be uncertain in its application; impose a significant compliance burden; and unnecessarily limit consumer autonomy and choice. Accordingly, the FSC does not support the Government adopting FSI recommendation 21.

In addition to existing disclosure obligations (in particular, the requirement for information to be 'clear, concise and effective'), financial services licensees are already subject to an extensive range of obligations including section 912A of the *Corporations Act 2001* (Corporations Act) which requires licensees, amongst other things, to do all things necessary to ensure that the financial services they offer are provided 'efficiently, honestly and fairly', and that any conflicts of interest are adequately managed. These provisions exist to help ensure consumers are treated fairly and have adequate information to make informed financial decisions. Of course, no law can prevent unethical or fraudulent behaviour. Instead, a combination of adequate disclosure, improved financial literacy, compliance with the law, and regulator enforcement is critical to ensure positive consumer outcomes.

To create an additional product design and distribution obligation would be to impose a significant compliance burden on financial services providers (FSPs), as it is proposed that the product be assessed for suitability, by *both* the product manufacturer and distributor, during the product design phase, product distribution process, *and* after the sale of a product. A continual cycle of product review is impractical, costly and will stifle productivity and innovation.

For example, a situation could arise in a post sale review whereby a product issuer no longer considers the product to be 'suitable' for a class of consumer, whilst a distributor, takes the opposite view. Similarly, there may be circumstances where a consumer wishes to purchase a product or service despite the provider and/or distributor not believing it is suitable for a consumer within that class – would the consumer be prevented from purchasing the product?

The person best placed to determine whether a product is suitable for a client is the consumer and/or their financial advisor. In the case of advisers, they are already required to act at all times in the 'best interests' of their clients (section 961B, Corporations Act), and provide 'appropriate advice' (section 961G, Corporations Act). The 'FOFA' reforms are already being implemented, and should not be supplanted by additional, potentially conflicting and unclear obligations.

Further, the introduction of a product design and distribution obligation is likely to engender uncertainty as to its application and may lead to litigation as to the obligation's exact parameters.

The FSC notes that the proposed obligation is intended to cover both complex *and* non-complex products. We believe that for non-complex products in particular, the introduction of such an obligation is not justified. Indeed ASIC's discussion of product suitability is limited to complex products in its Report 384 (Regulating Complex Products), released in January 2014, recognising that complex products, due to their nature, can be difficult for investors to understand, which can lead to them being mis-sold (see also ASIC Report 400: Responses to Feedback on Report 384). Such risks are significantly reduced where the product is non-complex, and therefore do not warrant additional government regulation.

Product suitability type obligations already exist in some areas, for example in credit (responsible lending rules) and superannuation (default/MySuper products). However these areas, which involve individuals consuming compulsory or otherwise essential products, can be contrasted to wealth management products, which fundamentally involve an investor assessing how they wish to utilise their disposable income. Additional regulatory intervention is not warranted where the transaction is fundamentally one of choice rather than need (credit) or compulsion (superannuation), and particularly given the obligations of AFSL holders under the Corporations Act. Where a product or service is considered 'too risky', it is open to the Parliament to legislate to prevent it being offered to consumers.

RECOMMENDATION:

The FSC recommends that the Government not introduce a new and unnecessary product design and distribution obligation given: existing multi-layered obligations on financial services providers; implementation risks associated with the proposed obligation; the significant compliance burden it would impose; and the negative impact such an obligation would have on consumer autonomy and choice.

FSI RECOMMENDATION 22:

Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.

This proposed product intervention power would allow: product banning; distribution restrictions; warnings/labelling; and amendments to marketing and disclosure materials.

The FSC has concerns regarding ASIC being given such a wide-ranging power, and does not support FSI recommendation 22. In our view, a strong enough case has not been made that ASIC is unable to carry out its mandate with the powers which it is already has. Currently, ASIC can intervene where license conditions/law has been breached. In particular, a stop order is an administrative mechanism that allows ASIC to prevent offers being made under a disclosure document where ASIC believes it contains: a misleading or deceptive statement; an omission of information required to be provided under the legislation, or a new circumstance has arisen since the disclosure document was lodged. Such stop orders have been utilised by ASIC, for example in the area of mortgage funds.

Further, we note that the proposed new discretionary power could be exercisable by ASIC even where there has *not* been a suspected breach of the law. In practice this means that a FSP could issue a product which complies with the law, but ASIC could nonetheless, exercise its intervention power. Such ASIC action could have a major market and reputational impact on the FSP.

We believe that the scope of permitted products or characteristics is not a matter which should be delegated beyond Government/Parliament – rather, to the extent it was considered necessary to proscribe a product or product characteristic, for certainty it should be set out in legislation or regulations, and not a matter for regulator discretion.

There is also a potential moral hazard, in that ASIC may feel obliged to exercise the power or risk consumers viewing a lack of ASIC action as an implied endorsement of a product's suitability for them.

Although we understand it is intended that such a significant power, if introduced, only be exercised as a 'last resort', it is important that it be constrained through appropriate accountability and oversight mechanisms, including judicial review. If such a power is introduced, in order to ensure procedural fairness, and prevent wasted resources, potentially affected FSPs must be afforded the opportunity to present their position prior to any ASIC decision to exercise the power.

It would also be appropriate to consult with APRA, where the affected entity is APRA-regulated. Further, in the interests of transparency, ASIC should be required to provide clear guidance to industry regarding the instances where ASIC may consider using such a power.

In relation to the launch of new product types, if ASIC is provided with a product intervention power, there should be an arrangement for a product issuer, *prior to issuing the product*, to approach ASIC (should the product issuer wish to do so) for prior confirmation that ASIC will not exercise its product intervention power.

We note that rapid change can make it difficult for regulators to keep pace with technological developments or market innovations. However this is a perennial issue that faces all governments, and not peculiar to financial services. Such a fear must be balanced against the need for industry to harness technology and promote innovative products/services. A common theme in the FSI report is that government should encourage, rather than stifle innovation. Were a product intervention power is introduced, it is important that it not be exercised merely in circumstances where the product is new or innovative.

We agree that if a Financial Regulator Assessment Board were to be introduced (see FSI Recommendation 27), it will be important that the Board carefully consider ASIC's exercise of such a power. Reporting to Parliament and in ASIC's Annual Report should be additional accountability mechanisms to ensure that the power is used appropriately, and only in exceptional circumstances, were the power to be introduced.

RECOMMENDATION:

The FSC recommends that the Government not provide ASIC with a product intervention power given ASIC already has wide-ranging powers which allow it to act where there have been breaches of the law or license conditions. The introduction of a new discretionary power would see ASIC stray into the field of mandating permissible products, a role which is properly the responsibility of the legislature. If introduced, the FSC recommends that the power only be exercised as a last resort, be constrained through robust accountability and oversight mechanisms, and that clear guidance be provided regarding the circumstances in which ASIC might exercise the discretion.

FSI RECOMMENDATION 23:

Remove regulatory impediments to innovative product disclosure and communication with consumers and improve the way risk and fees are communicated to consumers.

FSI RECOMMENDATION 39:

Identify, in consultation with the financial sector, and amend priority areas of regulation to be technology neutral. Embed consideration of the principle of technology neutrality into development processes for future regulation. Ensure regulation allows individuals to select alternative methods to access services to maintain fair treatment for all consumer segments.

The FSC has long-advocated for technology-neutral regulation and for the Government to better facilitate innovative, electronic disclosure. We agree that 'innovative disclosure can improve consumer engagement and understanding, and that industry should pursue innovative disclosure and alternative forms of communication' (FSI final report, page 215). In parallel, the FSC has provided a detailed submission to ASIC in relation to its Consultation Paper 224: Facilitating Electronic Financial Services Disclosure. Accordingly, the FSC encourages the Government to adopt FSI recommendations 23 and 39 in its response to the FSI final report.

The FSC believes that electronic financial services disclosure is a critical area where regulation and policy has not operated in a technology-neutral manner. We ask that the Government and ASIC prioritise reviewing legislation for technology neutrality, and ensure that any future regulation operates consistently with this principle. The FSC stands ready to assist the Government with this.

Better government facilitation of e-commerce and digital disclosure would yield positive outcomes such as increased customer engagement, a reduction in 'lost' customers (especially for superannuation members), and cost-savings associated with moving away from paper-based disclosure. More specifically, the financial and environmental costs of producing paper documents are both significant and likely to grow. This coupled with the expected increase in costs of postal deliveries means that continuing to produce large volumes of paper-based documents will become more expensive. While exact cost savings are difficult to estimate, some FSC members have estimated that their cost savings would be in the region of $1.7m each annually if electronic disclosure was the default.

The FSC believes that more innovative disclosure can also help encourage “consumers to be more engaged and to make more informed decisions about their finances” (FSI Final Report, page 193). The FSC is aware from third party research that many consumers do not read disclosure documents and can be regarded as “disengaged”. If, as the FSC believes is likely, the percentage of clients that read and understand the salient points of, for example, PDSs, can be increased, and the level of client engagement enhanced, then this will benefit both the client and FSPs.

If technology neutral regulation is not adopted across the board, the FSC fears certain customer demographics that are technology-aware will be disadvantaged both in the short term and in the long term. This is the corollary of the argument outlined in the Financial System Inquiry Final Report (see pages 269-270) that electronic service delivery may result in older Australians being excluded. In particular, younger customers – who as a demographic have demonstrated a high take-up rate for electronic communications – may disregard financial services that cannot be fully delivered electronically. In turn, this would negatively impact their savings and investment rates.

The current antiquated disclosure regime is costly (and this impacts the cost of products, and thereby consumers) and does not, in our view, provide superior consumer understanding or engagement compared to what is possible with various modes of electronic disclosure. This is particularly the case given an increasing proportion of consumers prefer and seek electronic communication. As ASIC Consultation Paper 224 acknowledges, Australia is well past the ‘tipping point’ where electronic disclosure is appropriate for most disclosures (Consultation Paper, paragraph 14).

It is critical that any Government regulation should be crafted in such a way that it does not limit providers to specific electronic disclosure mediums and is ‘future proofed’ (i.e. contains sufficient flexibility to adapt to new and unanticipated technologies). Overly prescriptive regulation would be counter-productive, and risks being quickly out-dated by technological advancements and innovation.

RECOMMENDATION: The FSC recommends that the Government implement Recommendations 23 and 39, in close cooperation with the financial services industry.

<u>FSI RECOMMENDATION 27:</u>

<u>Create a new Financial Regulator Assessment Board to advise Government annually on how financial regulators have implemented their mandates. Provide clearer guidance to regulators in Statements of Expectations and increase the use of performance indicators for regulator performance.</u>

Recognising the important role which regulators play in the overall financial system, the FSC supports robust accountability and transparency mechanisms. The FSC would welcome the introduction of a Financial Regulator Assessment Board, operating under a clear mandate, which would provide independent oversight of key regulators such as ASIC and APRA.

As set out in the FSI final report, the Financial Regulator Assessment Board should carry out annual ex post reviews of overall regulator performance against their mandates, including assessing how regulators have used the powers and discretions available to them. Increased scrutiny of the exercise of regulatory powers will be particularly important if ASIC is provided with new and additional powers, as has been recommended by the FSI final report. The Board should consist of representatives of a range of stakeholders including consumers and those with industry experience (but not currently employed by a regulated institution).

The FSC supports the Government providing more clarity around its expectations of regulators, including its appetite for risk in the financial system. We also encourage regulators to develop better performance indicators so as to more accurately measure themselves against their mandates.

RECOMMENDATION: The FSC recommends that a Financial Regulator Assessment Board be created - with a clear mandate – which would provide independent oversight of key regulators.

FSI RECOMMENDATION 28:

Provide regulators with more stable funding by adopting a three-year funding model based on periodic funding reviews, increase their capacity to pay competitive remuneration, boost flexibility in respect of staffing and funding, and require them to undertake periodic capability reviews.

FSI RECOMMENDATION 29:

Introduce an industry funding model for the Australian Securities and Investments Commission (ASIC) and provide ASIC with stronger regulatory tools.

The FSC recognises that FSI recommendations 28 and 29 are aimed at assisting the regulators to better execute their mandates, and the FSI final report's conclusion that ASIC is currently not adequately funded nor its staff competitively remunerated.

While the FSC has supported ASIC moving to an industry-funding model (on a cost recovery basis), this was contingent on the regulator having a more targeted mandate focused on non-prudential regulation, financial market integrity, financial literacy and international integration and competitiveness. The FSC fears that without a more refined mandate, ASIC will continue to struggle to carry out its duties, given resource constraints.

The FSC notes that the FSI has recommended ASIC be provided with broader powers including: the ability to impose licensing conditions without agreement/enforceable undertaking, a disgorgement of profits power and the need to obtain ASIC approval for material changes in ownership/control of a licensee. Further, it is proposed to increase the maximum civil and criminal penalties.

While the FSC supports the regulators being provided with the necessary powers to carry out their mandates, including a disgorgement power, we do not support some of the additional proposed powers including the ability to block material changes in ownership/control of a licensee, and proactively intervene regarding certain products (see FSI recommendation 22 above). Irrespective of the ownership of a licensee, the licensee is bound by its obligations as a licensee. ASIC already has the power to impose license conditions (with a hearing) where it has concerns regarding a licensee. To require ASIC approval prior to a material change in ownership is unnecessary given the licensee is bound to comply with the law.

Recognising the need to bolster ASIC performance, the FSC supports ASIC staff being excluded from the *Public Service Act 1999*. This should mean that staff are remunerated appropriately, commensurate with their level of expertise and sectoral knowledge, rather than rigid public service pay parameters. Concomitantly, a higher level of performance and accountability would be expected by industry, where an industry funding model has been adopted.

Consistent with the need to achieve high regulator performance and accountability, the FSC supports capability reviews taking place on a six-yearly cycle (i.e. aligned with every second funding review), as proposed in the FSI final report.

RECOMMENDATION:
The FSC recommends that: ASIC move to a three year funding model, with industry providing funding on a cost recovery basis; that ASIC staff be excluded from the *Public Service Act 1999* in order to retain and attract highly skilled staff; and that capability reviews of ASIC take place on a six-yearly cycle. The FSC supports ASIC being provided with the powers necessary to carry out its mandate, but has serious concerns regarding the introduction of a new product intervention power and the ability for ASIC to block material changes in ownership/control of financial services licensees.

<u>FSI RECOMMENDATION 30:</u>

<u>Review the state of competition in the sector every three years, improve reporting of how regulators balance competition against their core objectives, identify barriers to cross-border provision of financial services and include consideration of competition in the ASIC mandate.</u>

The FSC welcomes a greater focus on competition within the financial services sector, including periodic sectoral reviews. The FSC is hopeful that regulatory burden will decrease as a result of a greater Government focus on competition. Currently, the sector is subject to complex and costly regulation which operates as a significant barrier to entry, shutting out innovative new players.

The FSC has consistently advocated for the Government to remove impediments to, and better facilitate, financial services trade. Please see the draft FSC submission on funds management.

RECOMMENDATION:
The FSC recommends that there be a greater focus on competition within the financial services sector, including periodic sectoral reviews, and that the Government better facilitate financial services trade.

FSI RECOMMENDATION 31:

Increase the time available for industry to implement complex regulatory change. Conduct post-implementation reviews of major regulatory changes more frequently.

The FSC welcomes the FSI's recognition that there have been deficiencies in past Government consultations with industry, and that unrealistic implementation deadlines have been imposed upon the sector. In particular, we concur with the FSI Final Report that 'unnecessary compliance costs and poor policy processes are a concern' (page 260). As noted by the Ernst & Young analysis of the cost effectiveness of regulatory processes for the FSI, the identified shortcomings have included (page 258, FSI Final Report):

- "In some cases, it is not clear that detailed costs and benefits of changes have been considered.
- There are gaps in industry consultation processes; for example, they may occur too late to allow for efficient planning.
- Implementation deadlines can be optimistic."

The FSC would strongly support the Government allowing industry more time to implement complex regulatory change, and the conducting of post-implementation reviews to ensure regulation is operating as intended. If implemented appropriately, such changes should help reduce industry compliance costs, allow reforms to operate more efficiently, and avoid unintended consequences.

Taken together, FSI recommendations 23, 31 and 39, if adopted by Government, would represent a significant step towards better cooperation and partnership with industry.

The Financial System Inquiry FSI interim report highlighted the need for greater codification of Australian trust law.

RECOMMENDATION:
The FSC recommends that the Government implement Recommendation 31, so as to ensure that compliance costs are minimised and that reforms operate as intended.

Alternative Australian Trusts Act Proposal

As submitted to the FSI, and supported by detailed research, the FSC advocates for the creation of an Alternative Australian Trusts Act (Cth) (AATA) which would work to enhance financial integration, especially in the Asia Pacific region, and provide new, fit for purpose, legal infrastructure for

Australian trusts. Such legislation would provide a modern, codified and nationally consistent trust law.

A case is presented in support of an AATA, so as to boost the trustee, wealth management and private banking sectors, which in turn will promote GDP, tax revenue and employment growth in Australia. Modernising and codifying Australian trust law is essential to ensure that Australia's regulatory structures are competitive with other sophisticated financial system economies, including the UK, US, Singapore and Hong Kong. Such a reform would serve the dual domestic and international objectives of enhanced consumer protection and increased financial services exports.
Not only would an AATA strengthen corporate governance in the trust sector, it would also make a major contribution to the underlying regulatory infrastructure governing Australia's financial services markets. The AATA proposal is smart reform - instead of creating another layer of regulation it gives trust users a choice of legal infrastructure – that is, it would operate as an alternative regime which users could choose to opt-in to.

Three key benefits would arise from the adoption of an AATA. The first is that an AATA regime would provide certainty where there is currently ambiguity and therefore a lack of confidence, especially in respect of foreign resident participants in Australia's financial market. The current system of State and Territory laws is unduly complex and differs across jurisdictions. The certainty and stability of an AATA would attract offshore investors from the broader Asia Pacific region and would bolster protections of domestic retail clients because the role and powers of the fiduciary intermediary would be more certain.

Secondly, an AATA could deal with trust insolvency, and regulate the proper distribution of risk amongst financial market participants. If trusts are to continue to be used as an instrument of commerce, it is critical that the risk profile of trust entities be determined by public policy.
Lastly, the AATA proposal would establish a specific regime to empower and regulate licensed, capital-backed, fiduciary financial institutions.

Such fiduciary institutions could better serve as gatekeepers for the financial services industry by taking a more active role in protecting consumers, which in turn could relieve some of the regulatory burden on ASIC and APRA.

Accordingly, the FSC encourages the Government to adopt the necessary trust law reforms to better protect consumers and help bolster Australia's financial services exports. The AATA serves as a useful model to achieve these objectives.

RECOMMENDATION:

The FSC recommends that the Government introduce an Alternative Australian Trusts Act which would support financial integration, especially in the Asia Pacific region, and provide new, fit for purpose, legal infrastructure for Australian trusts.

APPENDIX A:

5 February 2015

By email: submissions@trowbridge.com.au

Mr John Trowbridge
Independent Chairman
Life Insurance and Advice Working Group

Dear Mr Trowbridge

Submission to Trowbridge Review of Retail Life Insurance Advice

The Financial Services Council (FSC) welcomes the release of your Interim Report, *'Trowbridge Review of Retail Life Insurance Advice,'* which assesses ASIC's Review of Retail Life Insurance and Advice report released on 9 October 2014. The Interim Report identifies a number of issues which need to be addressed in order to improve the quality of life insurance advice and remuneration practices.

Ensuring Australian consumers have access to quality life insurance advice and life insurance frameworks which place consumer interests first is imperative. The FSC welcomes the opportunity to make a submission to the Interim Report and makes a number of recommendations to improve consumer outcomes and address issues raised in the Interim Report.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees. The Council has over 125 members who are responsible for investing more than $2.3 trillion on behalf of 11 million Australians.

Nothing in this submission is, or should be taken as, any agreement, undertaking or understanding between any one or more of FSC's members to take or not take any action. FSC recognises that certain recommendations or proposals in this submission, if they were to be implemented, would require FSC and FSC members to obtain detailed legal advice and ACCC authorisation, prior to any implementation.

We welcome the opportunity to further consult on the issues raised in this submission. Please feel free to contact me on 02 8235 2513 if you have any further questions or comments in relation to this submission.

Yours sincerely

ANDREW BRAGG
Director of Policy and Global Markets

Summary of Recommendations

Recommendation 1: The proposed remuneration model (which has been developed solely for the purpose of responding to the interim Trowbridge report) be adopted by and implemented by the industry through a self regulatory mechanism, following ACCC authorisation or through legislation if a self regulatory mechanism is not feasible.

Recommendation 2: That the FSC establish a working group to develop a life insurance code of practice as proposed in this paper.

Recommendation 3: Following consultation on how Statements of Advice (SoAs) could be streamlined to better meet the spirit of the law, ASIC should work with industry to develop a streamlined SoA.

Recommendation 4: ASIC provide further regulatory guidance and practical examples on how the best interest duty can be met in the provision of life insurance advice.

FSC Submission to Trowbridge Review of Retail Life Insurance Advice

The following is the Financial Services Council Limited (FSC) submission outlining the key issues for our membership in relation to John Trowbridge's Interim Report (Interim Report).

It is assumed the FSC is making a submission with a view to engage in self-regulation at the conclusion of the Trowbridge and Financial System Inquiry (FSI) consultation processes.

The FSC welcomes the release of John Trowbridge's Interim Report which assesses ASIC's Review of Retail Life Insurance and Advice report released on 9 October 2014. The Interim Report identifies a number of issues which need to be addressed in order to improve the quality of life insurance advice and remuneration practices.

Ensuring Australian consumers have access to quality life insurance advice and life insurance frameworks which place consumer interests first is imperative. The FSC welcomes the opportunity to make a submission to the Interim Report and makes a number of recommendations to improve consumer outcomes and address issues raised in the Interim Report.

Nothing in this submission is, or should be taken as, any agreement, undertaking or understanding between any one or more of FSC's members to take or not take any action. FSC recognises that certain recommendations or proposals in this submission, if they were to be implemented, would require FSC and FSC members to obtain detailed legal advice and ACCC authorisation, prior to any implementation.

1. REMUNERATION

There are a number of principles that have led to the development of the FSC's proposed remuneration model which has been developed solely for the purpose of responding to the interim Trowbridge report. These are:

1. Improving the quality of advice consumers receive by encouraging behavioural change in the industry and minimising conflicts of interest;
2. Clear and simple design features that allow for an increase in the transparency of, and trust in, retail life insurance advice;
3. Reducing underinsurance in Australia by increasing the affordability and accessibility of retail life insurance;
4. Recognising and accommodating for the significant upfront costs, time and effort required of advisers when placing consumers into an appropriate life insurance product;
5. Encouraging innovation in the industry for the benefit of consumers;
6. Increasing the sustainability of the life insurance industry.

In order to address misaligned incentives in the provision of life insurance through personal advice, the FSC proposes the following design features for adviser remuneration of retail life insurance products:

1. Remove high up front commissions from inception;
2. Move to a level percentage commission structure so that the upfront commission for life insurance advice is no greater than ongoing commission on an industry wide basis. This level should be lower than current market rates for level commission arrangements, for example in the region of 20 per cent;
3. Incorporate an optional additional first year adviser service payment that would be a capped percentage of the premium's value (payable only to a premium size cap applied on an industry wide basis) to provide partial, but not total, compensation to advisers for up-front costs. This payment would be subject to a responsibility period (see design feature 5);
4. Design feature 2 and 3 should result in total first year remuneration for an adviser being significantly lower than existing rates for hybrid commissions. The FSI Final Report suggested that the percentage amount of level commission is a matter which should be left to the market and industry to determine. Detailed modelling would be required on such matters;
5. Extending the responsibility period (clawback of adviser payments) and applying it to the additional service payment;
6. Removing other incentives that create conflicts (discussed in detail below); and

7. Reviewing the application of this proposed model by 2020, with a commitment to consider alternatives if the proposed model is failing to achieve its objectives.

The design features of the FSC's proposed model which has been developed solely for the purpose of responding to the interim Trowbridge report are discussed with reference to our principles to demonstrate key issues for final consideration. The implementation of any agreed remuneration model will require ACCC authorisation or legislation. Full industry participation in a self regulatory response is required for this to be feasible. If this cannot be achieved, legislating the appropriate remuneration model would be required.

Removing high up front commissions

The FSC strongly supports views put forward in the Trowbridge Interim Report that high up front commissions should be removed or banned. Any model must incorporate this design aspect in order to remove any real or perceived conflicts of interest in the retail life insurance advice process.

Removing this conflict will improve the quality of advice and represents a significant shift in industry practice. Further, it presents a clear and simple message to all stakeholders that the industry is serious about making the necessary change to protect consumer interests.

A lower level commission, and a partial service payment is the intention

Design aspects of a level commission and a service payment (both discussed below) should result in total first year remuneration for an adviser being significantly lower than existing rates for hybrid commissions.

We note the FSI Final Report suggested that the percentage amount of level commission is a matter which should be left to the market and industry to determine. Detailed modelling across the industry will assist in determining an appropriate quantum of level commission and service payment arrangements.

Moving to a level commission structure on an industry wide basis

Level commissions, where the upfront commission for life insurance advice is no greater than ongoing commission, are clear and simple to explain and understand. They remove the incentive to inappropriately switch the customer's life insurance policy. A level commission structure will result in a meaningful change across the advice industry that will assist in cultivating an environment conducive to behavioural change. This level should be lower than current market rates for level commission arrangements, for example in the region of 20 per cent (given current market rates for level commission are in the order of 30 per cent).

An additional, optional first year adviser service payment that is capped

An additional service payment in the first year would be permissible based upon a capped percentage of premium. It would be payable only to a premium size cap applied on an industry wide basis.

An additional first year service payment is made in recognition that advisers incur upfront costs that require compensation. However, it is important to note some important design elements of this component of the proposed model:

1. The service payment design should ensure appropriate tax treatment [1] and make the proposed model administratively easier to implement using existing systems.

2. The quantum of the service payment should only partially compensate the adviser for the work required to place a client in a policy. It should not reflect full compensation, be overly generous or include a profit margin.

3. In determining the appropriate quantum, reference to the impact of the payment on adviser productivity should be considered – noting a lower payment may create an incentive for advisers and manufacturers to improve their productivity.

Individual advisers may choose not to accept the additional upfront service payment or the level commission. The premium cost to the client would be reduced where the additional first year payment or the level commissions are not charged. As always, advisers and licensees are always at liberty to use a fee for service model.

Advisers would recoup the cost of advice through a fee for service payable by the client for the advice provided. Current mechanisms are in place to support this in the market.

Extending responsibility periods

Extending the responsibility period and applying it to the additional service payment is designed to encourage behavioural change and ultimately improve the lapse experience.

It is important to note that an increased responsibility period alone will not solve sustainability issues in the industry. This element of the proposed model becomes more important as the quantum of the additional service payment becomes larger. If the additional service payment was significantly small enough, responsibility periods may not be required. No responsibility period would be required where an additional first year service payment is not being charged.

The clawback under the responsibility period should be simple to understand and apply. The clawback would apply to all discontinued policies.

Banning other incentives that create conflicts

Other incentives can have the effect of circumventing the intended purpose and objectives of any revised remuneration model and should be removed. Removing incentives that create conflicts are designed to better align with consumer interests. This includes monetary and non-monetary incentives given to advisers or licensees, whether direct or indirect, that create conflicts of interest

[1] If payment from insurer to the adviser is not within the premium paid by the customer then it would mean the total cost of insurance (i.e. the premium plus the additional service payment outside premium) would incur a different tax outcome in the hands of the customer.

and should be prohibited.[2] Examples of incentives that should be removed include volume bonuses to advisers and licensees.

With the exception of introducing the new remuneration outlined above, we would be supportive of introducing a ban on conflicted remuneration applicable to insurance advice similar to the conflicted remuneration provisions which currently apply to investments under FOFA. An appropriate transition would be required.

Implementation Mechanism

The industry favours a self regulatory response. The implementation of any agreed remuneration model on a self regulatory basis will require ACCC authorisation.

Further, full industry participation in a self regulatory response is required for it to be feasible. If this cannot be achieved, legislation would be required.

Transition

There remain important questions which could be examined in the final report about the financial effect of a new remuneration model on new financial advisers joining the sector. Given the life insurance sector has served as the foundation of the advice sector for all Australians, it is important that any new model ensures that there remains good reasons for new life insurance and financial advisers to join the sector as well as ensuring a sustainable life insurance and advice industry going forward.

Moving towards this proposed remuneration model would require ACCC authorisation or legislation with a phased approach over two years from an ACCC determination process or legislation being enacted. The two years would allow a day one transition step, a 12 months transition step, with the proposed FSC model implemented after 24 months.

A number of specific transition issues will require further consultation with industry, including:

- How any transition steps and states will be designed, and monitored;
- How rules around existing life insurance books will be designed and monitored so as to avoid any unnecessary pre-implementation switching from existing remuneration arrangements to the new remuneration arrangements, i.e. how will existing policies be treated; and
- How licensees will assist in educating advisers in order to assist them with the transition to the proposed model and remuneration practices.

Reviewing the application of this model by 2020

Any proposed model that is implemented should be reviewed by 2020 in order to assess its effectiveness. If the model fails to improve consumer outcomes, further action should be taken to

[2] The proposed remuneration model would be expressly permitted and would not be included in the prohibition against incentives that create conflicts.

adjust remuneration models so that they do not misalign incentives in the retail life insurance advice value chain.

Recommendation 1: The proposed FSC model be adopted by and implemented by the industry through a self regulatory mechanism following ACCC authorisation or through legislation if a self regulatory mechanism is not feasible.

2. CODE OF PRACTICE

The FSC supports an Industry Code of Practice which would be similar to the codes maintained by the Insurance Council of Australia and Australian Bankers' Association wherever practicable.

A Code of Practice would be a useful tool for the protection and benefit of consumers.

This would likely be a code which is agreed by the FSC's life insurance members.

Preparing a code could take in the region of 12 months to allow sufficient time for adequate consultation. The working group would design a code of practice that covers minimum standards and areas of best practice that members must meet. The working group would consider and define:

- Overall objectives;
- Scope and application across markets and products;
- Measures associated with an industry wide replacement framework;
- Specific areas of conduct the code will cover, such as:
    - Standard/minimum benchmark around how claims will be dealt with, such as within which period.
    - Specific areas of conduct identified as not in the interests of consumers, and how insurers would deal with such conduct.
- Subscribers to the code;
- Stakeholder groups;
- Consumer disclosures;
- The appropriate level of prescriptiveness in the code, bearing in mind the need to comply with competition law; and
- Monitoring, enforcement and governance.

The final code would be approved by the Board of the Financial Services Council.

Recommendation 2: That the FSC establish a working group to develop a life insurance code of practice as proposed in this paper.

3. INDUSTRY PRODUCTIVITY

The FSC is supportive of initiatives which would reduce the regulatory burden on licensees and advisers and in turn drives adviser efficiency which ultimately benefits consumers. Hence, we support a thorough investigation as to how Statements of Advice (SoAs) could be better structured. SoAs should meet the spirit of the law on conduct, disclosure and the Best Interest Duty (BID) in a way that makes them more efficient to produce and more able to obtain informed client consent.

Such an investigation into efficiency will need to exercise caution not to introduce mandated requirements across all SoAs.

Incentives are already high for industry to invest in productivity enhancing measures outlined in the Interim Report. It would be inappropriate and remains unnecessary for industry to be compelled through regulations or any other additional mechanisms to invest in further initiatives that increase productivity measures that are most relevant to their business.

Recommendation 3: Following consultation on how SoAs could be streamlined and meet the spirit of the law, ASIC to work with industry to develop a streamlined SoA.

4. OTHER

Quality advice and culture

The FSC is supportive of improving the quality of advice to consumers. A number of areas impact on the quality of advice, including risk management practices such as Approved Product Lists, training and education, industry standards, and legislative requirements.

Licensees typically review and assess products for inclusion in an Approved Product List (APL) for advisers to offer their clients. APLs often form part of a licensee's risk management process, ensuring that products retain competitive pricing/features, reviewing underwriting and claims processes, support services to advisers and clients, as well as the financial strength of the insurance provider.

Approved Product Lists offer efficiency to advisers, providing advisers with comfort that the products on the list have been reviewed and approved by the licensee's own internal governance and research process and deemed suitable for inclusion on the APL.

This provides an additional layer of risk management which is followed by the adviser's own review of insurance products in order to determine which product may be suitable for and be in the best interests of a client. This saves the adviser from researching each and every product themselves, which would not be efficient for the purposes of providing advice to retail clients, and would serve to increase the cost of advice to the client.

In addition to improving the quality of advice, the FSC is also supportive of increasing adviser standards. The FSC provided extensive feedback on increased adviser education and standards via its submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into proposals to lift the professional ethical and education standards in the financial services industry

(PJC). The PJC issued a report in December 2014 which made a number of recommendations on increasing education standards and incorporating professional standards.

The industry is reviewing the recommendations to increase professional, ethical and education standards and it is likely the government will also review the recommendations of the PJC to determine a suitable course of action.

The FSC considers that changes to life insurance education standards are best addressed with other education area requirements for financial advice provision more broadly. Education standards are best raised on a holistic basis and should be addressed through an industry wide response to the PJC recommendations.

In the mean time, a number of large licensees have already announced increased adviser education standards for the advisers within their own networks and are supportive of raising the standards for the benefit of advisers and consumers.

ASIC has also included a Life Insurance and Advice Checklist to assist with the provision of quality advice to consumers. The Interim Report raises a number of questions on how the Life Insurance and Advice Checklist could be adopted by licensees and advisers. Many of the components of the adviser checklist would already be undertaken by an adviser in discharging their best interest obligation.

The FSC believes that licensees and advisers should incorporate relevant aspects of the checklist within the compliance and advice process and considers that prudent licensees are likely to have already implemented this. To the extent that elements of the adviser checklist are better incorporated into broader adviser standards, these should be incorporated into professional standards framework for advisers.

To further assist with quality insurance advice, it would be helpful if ASIC could provide further practical examples of how the best interest duty can be met in relation to the provision of life insurance advice via regulatory guidance. This could be achieved by updating RG 175 Licensing: Financial product advisers – conduct and disclosure or a specific regulatory guide in relation to life insurance advice.

Recommendation 4: ASIC provide further regulatory guidance and practical examples on how the best interest duty can be met in the provision of life insurance advice.

APPENDIX B:

PRODUCT RATIONALISATION WORKING GROUP PROPOSAL

PROPOSED PRODUCT RATIONALISATION MECHANISM

1. FINANCIAL PRODUCT RATIONALISATION SCENARIOS

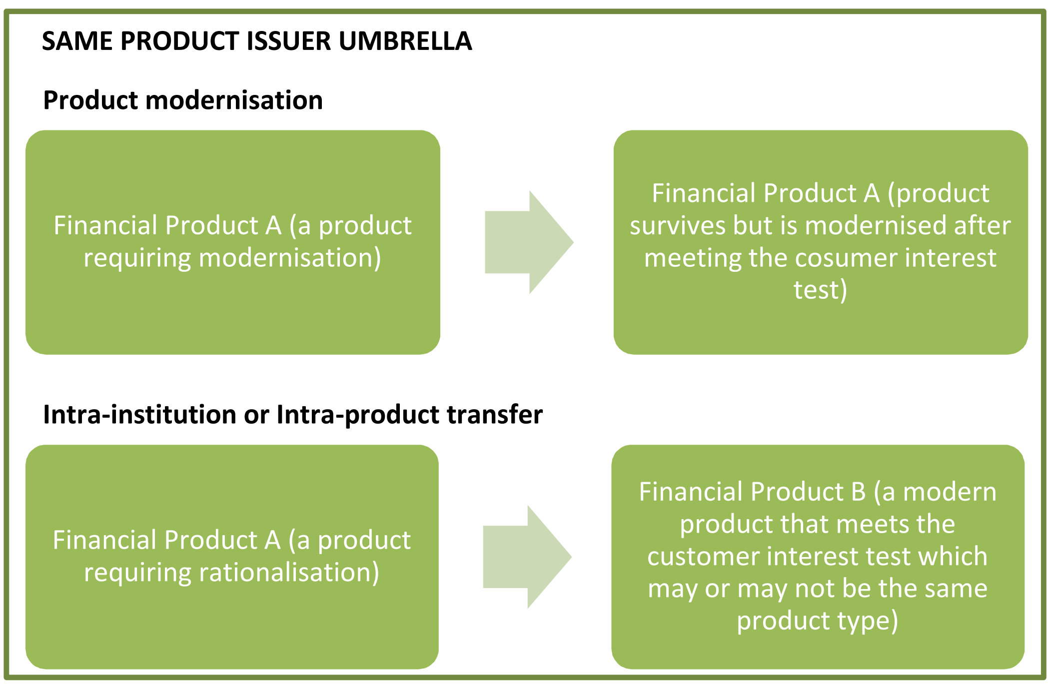
Under Part 9 of the Life Insurance Act 1995 (Cth) and the Financial Sector (Business Transfer and Group Restructure) Act 1999 (Cth), there is a process for the merger of the statutory funds of two life companies or the transfer of part of the life insurance business between them however this is too complex and expensive for wide scale use.

Enabling consumers to move into a more competitive, efficient and modern product will improve competition and efficiency in the industry. In practice, achieving this outcome may involve the transfer or simplification of a financial product under a range of different scenarios. The FSC has captured these scenarios below and believes all can be achieved by leveraging the common framework proposed above. We would be pleased to provide more detailed information and also to elaborate further on being able to transfer consumers between product types which would provide positive consumer and industry outcomes.

a. Internal simplification

This scenario involves:

- Transferring a consumer from one product to another issued by the same product issuer; or
- Leaving the consumer in the product they are currently in and changing it, or an underlying structure which supports the product, such as an investment structure.

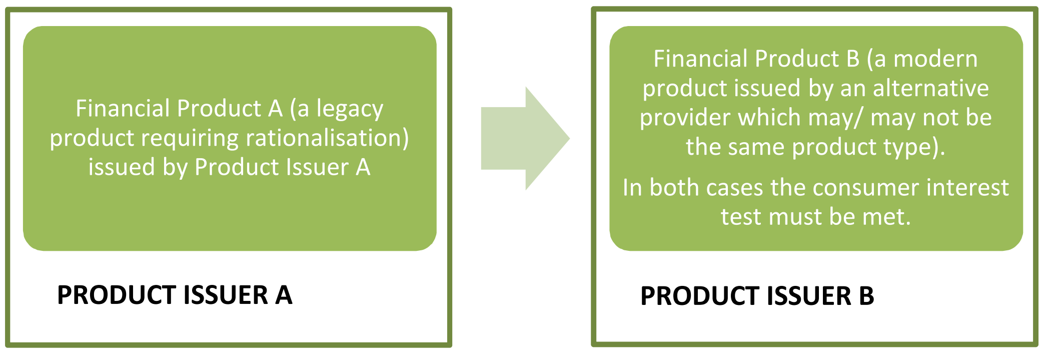


b. External simplification

This scenario involves:

- Transferring a consumer from one product to another issued by a different product issuer, whether that product is of the same kind or a different financial product. In practical terms this could be a life product to life product transfer or the transfer from one financial product to another financial product; or
- Substituting the current product issuer for another product issuer.

Inter-institution transfer or Inter-product transfer



c. Termination of product

When a product is no longer economically viable and has a very small number of remaining customers, a product provider can either terminate a product on the basis of the interests of consumers (returning their monies) or transfer the client(s) to a substitute product.

This mechanism would obviate the need to increase fees to in order to pass on the high costs of operating legacy products and the continuing cross-subsidisation of legacy products by the majority of consumers who are invested in contemporary products. This termination mechanism should be able to be exercised unilaterally by the product issuer and override any individual arrangements between the product issuer and the client.

2. APPLICATION OF TEST UNDER DIFFERENT PRODUCT TYPES

a. Life Insurance

Life Insurers cannot rationalise products under the current legislation, which requires the life insurer to ensure each individual policyholder is no worse off under any individual policy condition, despite such change being:

- In the **interest of the majority** of consumers.
- **As an overall package** of benefits and services, in the interests of an individual consumer, despite an individual condition being less advantageous.

While in theory consumer consent could be obtained to upgrade consumers, this is impractical. Under Part 9 of the Life Insurance Act 1995 (Cth) there is a process for the merger of the statutory funds of two life insurance companies. However, this provides limited practical benefit even in a merger (as only minor changes can be made) and does not assist a life insurer rationalise its own portfolio.

Over time and to meet prevailing market needs, a life insurer may have issued hundreds of individual products, which may also have been further customised for individual customers. Given the significant variation between policy terms, life insurers are effectively locked out from upgrading consumers to modern products as the current exercise of ensuring all consumers are no worse off is too arduous and unsustainable for life insurers to participate in.

The lack of a product rationalisation framework for life insurance is a significant barrier to product innovation in life insurance because life insurers don't want to be left with small portfolios of policies from innovation initiatives which are costly to administer. This stifles product innovation and in fact makes innovation very difficult. Ultimately the consumer loses as a result

Reinsurers also play an important role in the viability of any future rationalisation framework as should they reinsure the policy, they would need to consent to changes. Reinsurers should provide consent on the basis of independent actuarial advice confirming that they are not materially impacted.

Recommendation:

1. Amend the Insurance Contracts Act to allow life companies to unilaterally amend policy terms where a consumer interest test is satisfied when comparing the overall bundle of benefits the consumer currently has versus the proposed changes.
2. If a reinsurer is involved, independent actuarial advice should be sought prior to the action that confirms reinsurers are not materially impacted by product rationalisation and if so, they should provide consent to the change.

b. Managed Investment Schemes and IDPS

Many organisations operate managed investment schemes (registered or unregistered) which, due to their size or numbers of members are no longer efficient to operate. This may arise because a scheme is closed to new members and over time redemptions have reduced the size of the scheme (but the cost base has stayed the same or increased) or because mergers have resulted in duplication in the investment strategies of funds in the group.

For example, post merger a group may operate two emerging markets funds and it would be more efficient (and cost savings could be passed on to investors) if the funds could be merged.

It is difficult under the current legal framework to transfer investors from inefficient schemes to more modern or more sufficient schemes. For registered and unregistered schemes generally a 'trust scheme' is needed which requires meetings to be convened and generally requires applications to court for judicial advice, the outcomes of which are uncertain and the costs of which can be significant.

If transfers are not viable the only other real alternative is termination. Again, the outcome may be uncertain and the costs may be significant as a meeting may be required to amend the trust deed or seek member approval (a meeting is mandated by the Corporations Act for a registered scheme) and judicial advice may be needed. The termination of the fund may also crystallise any capital gains for the investor.

As these managed investment scheme problems arise in relation to all types of schemes the FSC proposes that the solution be made available to all categories of managed investment scheme, including:

- IDPSs, which are generally classified as unregistered managed investment schemes (because investors have the expectation of cost savings or access to investments that would not otherwise be available to them and are exempted from registration where they meet certain conditions); and
- IDPS-like schemes which operate similarly to IDPSs but are registered managed investment schemes.

Recommendation:

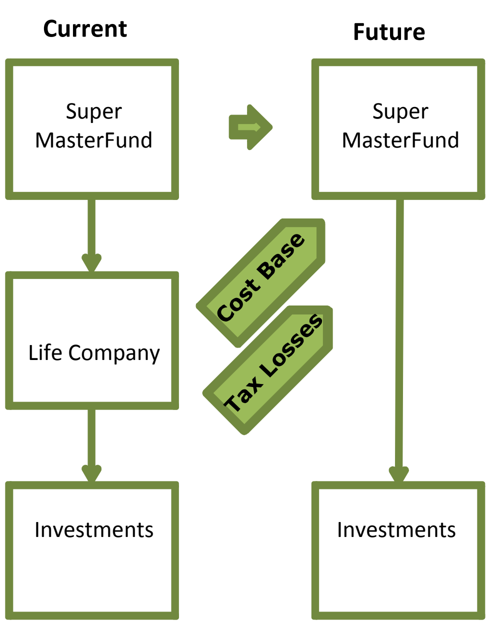
3. Permit the transfer of all the members from a legacy scheme (e.g. a scheme that is economically inefficient or out-dated) to another fund where the responsible entity or trustee considers on reasonable grounds that those transfers are in the interests of those members as a whole.
4. Introduce a more streamlined regulatory regime for the transfer of REs within a corporate group.

c. Underlying Structures

Facilitation of transfers between investment portfolios applicable to a financial product should apply to both life-backed investment portfolios as well as investment portfolios structured as managed investment schemes or pooled superannuation trusts. Such facilitation would allow for a transfer between portfolios without consent of affected investor(s) but subject to the consumer interest test.

For example, “life-backed superannuation product” is a commercial term that describes a superannuation fund offering super products with investment options invested through an investment policy from a life insurance company. The investment policy comprises of investment options similar to those offered by the superannuation fund.

The life insurance company invests the moneys “assigned” to those investment options under the investment policy under a mandate which supports the investment aims of the corresponding option offered by the super fund (e.g. growth option, conservative option, or in the case of the default fund, the life company would commonly invest the moneys assigned to either a balanced investment option or the appropriate life cycle options).



For many providers, the investment structure of life-backed superannuation products is a legacy of retail funds seeking to utilise benefits associated with the life insurance structure which were of greater benefit historically than today. For many providers, these benefits have now been eroded however the trustee and consumers remain “trapped” in the life policy structure which now results in an unnecessary impost of inefficiency, additional cost and red tape. Importantly, our proposal mirrors that of the existing rollover relief for the merger of superannuation funds, so is building on an already established framework.

Recommendation:

5. Having met the consumer interest test, the transfer of investment portfolios including life backed superannuation products to a modernised regime should involve:

   a. Members are switched from an investment option under a life policy to which they are invested into a corresponding investment option that is offered in the new directly investing product in the same superannuation fund.
   b. The manager of the investment option (in the case of life policy, the life company) disposes of the assets (the units in investment trusts)
   c. The superannuation MasterFund will withdraw its investment policy with the Life Company.
   d. The Superannuation MasterFund will acquire the same units in investment trusts, as disposed of by the manager of the investment option.
   e. The rationalisation mechanism should operate without tax consequences.

6. Having met the consumer interest test, the transfer of life company superannuation annuities to a modernised regime (a regulated superannuation fund) should involve:

   a. Policyholders switched from an investment option under the superannuation policy to which they are invested into a corresponding investment option that is offered in the superannuation fund.
   b. The life company transfers the assets to the trustee of the superannuation fund.
   c. The policyholder's rights under the superannuation annuity are extinguished and replaced by an interest in the superannuation fund.
   d. The superannuation fund will acquire the same units in the investment trust as disposed by the life company or acquire an investment-only policy with the life company relating to the same investment options.

3. OTHER CONSIDERATIONS

Overall the super mechanism works well from a consumer and product issuer perspective and has been used considerably by the industry in recent years to the benefit of all industry stakeholders.

Although it is outside of the scope of the FSI Panel's recommendation, which deals exclusively with life insurance and managed investment scheme legacy books and underlying structure rationalisation, there is scope to revisit one element of the current superannuation rationalisation mechanism.

Allowing holders of a term allocated pensions (TAPs) and other exempt pensions to easily commute their benefits into an account-based pension where they no longer receive any social security benefit from maintaining the pension would be a valuable improvement to the existing regime.

This would provide existing TAP and other pension holders with greater flexibility and choice in relation to how they can manage their retirement benefits.