SALLY LOANE, CEO, FINANCIAL SERVICES COUNCIL

The Summit 2018

Thursday 26 July, 12.00pm

Thank you all for being here when there is so much currently occupying our attention. This Summit is always booked a year in advance – and the timing has been challenging this year given the Royal Commission – so the team and I very much appreciate the fact that so many of you are here.

A special thanks to our all our brilliant speakers for their contribution to the industry conversation and to our sponsors for this event – particularly PwC – our platinum sponsor.

Thanks also to our other conference partners: Conexus Financial, who very kindly supported the Gala Dinner last night – thank you Colin for helping us raise $133,000 for First Nations Foundation. Over the past six years FSC members have given a total of $1.2 million in support of First Nations, a unique Foundation which has to date found $7 million of lost super for Aboriginal people. Such fantastic work, it's been a privilege to be involved.

Thanks to our other wonderful Summit partners - APIR; Bravura; EMLife; Fairfax Media; Jade Software Corporation; Lab Group; MLC Life; Portfolio Construction Forum/CIMA, RBC; the Sydney Kings and our media partner *Money Management*.

Setting the scene

There are tectonic shifts in our sector–

- much of it in the M&A space as three major banks have sold or are selling their wealth businesses;
- the Royal Commission continues its work, with superannuation in focus in a few days' time;
- the Productivity Commission has delivered a transformational review of superannuation
- the Government's far-reaching Budget changes to life insurance in super are before Parliament, as are three separate super bills designed to enable choice, competition, transparency and better governance of funds..

- the Budget also introduced the Retirement Income Framework which included the Covenant, ensuring greater emphasis is placed on the retirement end of the system.

Scrutiny of our sector by media and regulators, and the Honourable Kenneth Hayne and his team is intense, and poses many challenges. Questions have been raised about the future of vertically-integrated business models, the sustainability of group insurance, the so-called "grandfathering" of advice products and how superannuation funds spend members' money.

The powerful funds management industry is far from immune from the changes as it continues to experience fee pressure from low-cost index funds, additional reporting requirements and global questions about the gender diversity of its workforce.

Regulators are muscling up, with new funding, new structures and new leaders.

And if that wasn't enough, 2019 will be a Federal election year.

Overlaying all this, technology is creating disruption – super funds, life insurers and advisers are all being changed in the way they deliver products and services – a small tsunami of fintechs is nibbling at this massive market. The arrival of open data for banks this time next year will only accelerate change.

The SuperStream technology means it's now easy for an employer to make super contributions into a number of different funds for their staff.

It is critical that we who are proud to work in financial services understand that all these elements are not to be feared – they present opportunities to do even better for Australian consumers. Carpe diem!

Snapshot

These waves of change are not without major consequences because of the size of financial services. Together with banking, financial services is the biggest contributor to the national economy, adding around $150 billion in 2016-17. Our products and services touch every single consumer.

Assets in superannuation funds now total more than $2.6 trillion and our system is ranked third best in the world in the Melbourne Mercer Global Pension Index.

The Australian funds management industry as a whole accounts for more than $3.4 trillion in funds under management – more than double the size of the total combined market cap for ASX 200 companies. We have the sixth largest funds management industry in the world whilst ranking only 54th for population.

Australians are served by some 25,000 financial advisers;

]The nation's life insurers paid out $9.5 billion in claims in 2017.

Market shifts research

Let's have a look at the different parts of financial services.

Driven by the steady march of superannuation contributions, each of the constituent parts of our industry are showing decent growth in aggregate, as you would expect. But market dynamics are changing.

Both the superannuation and life insurance sectors are becoming more concentrated.

[SLIDE 1 - Super slide]

Funds under management in super have increased by 220 per cent in a decade. However, there are now 53 per cent fewer superannuation funds –that consolidation will continue.

[SLIDE 2 – Life Insurance slide]

As you can see, there are 10 per cent fewer life insurers in the Australian market compared to a decade ago. Premium volumes have increased, as have global players.

[**SLIDE 3 Funds Management slide**]

Funds under management have grown by 33 per cent. However, fund managers face sterner competition, with 13 per cent more participants entering the Australian market in the last decade.

Many global players are attempting to increase their footprint in Australia to capture our retirement savings pool.

Funds are also concentrating at the top end, either by organic growth or through M&A activity.

SLIDE 4 – ADVICE:

Financial advice is going through its own unique makeover with significant growth in the number of licensees – up 250% – in the last decade. This shows the fragmentation of the adviser groups which is ongoing.

<u>The vertically integrated business model</u> continues to be much discussed and versions of it are widespread.

Research shows that 43 per cent of industry super funds have an associated internal advice licence, representing 58 per cent of industry super funds under management. Thirty five per cent of industry super funds have an associated fund manager.

Trust

All of us in this room have been challenged by many of the issues examined by the Royal Commission.

<u>For poor behavior there can be no excuse.</u>

We must face up to what has been revealed, determine what went wrong, be accountable to consumers and make it right for them, review our governance and processes and make sure it doesn't happen again.

There is much we can learn from how others deal with crises. In the 80s there was serious and systemic Medibank fraud by a few rogue doctors, but the medical profession overall was badly tarnished. It was a long road back to being trusted but they did it, mainly because individual Australians trusted, often loved, their own family GPs.

Mining companies were the bad boys for decades until they realised that they had to repair, restore, and actively grow the local communities they worked in. The miners had to demonstrate they were there for the long haul and individual workers and their families became valued members of those communities.

I left a long career in journalism to work in the corporate sector, and turned from reporting crises, to trying to prevent them or solve them. A couple of months in to my new job at Coke there was a big one. The lead critic was Alan Jones. The issue was tough, it concerned a contractor who'd been badly injured at work, he'd actually been shot by an assailant. His legal claim had taken a decade to wind through the system and when it emerged, didn't go this man's way. It was a David and Goliath scenario – the battler v the big company – and the media caned us, day after day.

It taught me a good lesson about what happens when things go wrong that are not immediately fixed. They can turn into crises, especially when they get forgotten about, ignored, buried, or just inadvertently lost in the system, over a period of years. As our reputation burned under the media spotlight, fixing the issue fast was paramount – we needed to apologise, right the wrong, and make sure it couldn't happen again.

<u>So what do Australians think of us?</u>

Despite the fact that our products and services touch the lives of almost every single Australian, the reality is that the vast majority of people don't have high levels of understanding of what we all do.

When people take out life insurance, choose a super fund or an investment portfolio, or find a financial adviser to help them navigate the complexities, they take a leap of faith.

To take a leap of faith requires trust.

In financial services trust can be built on personal relationships – it's no accident that surveys find that people place high levels of trust in their own financial advisers – it's a strong relationship.

There are powerful opportunities for all of us as individuals to regain and strengthen the existing trust that exists in the community. It's not gone, but it needs massive attention.

I like what James Shipton says about trust - He says there are three things that need to be applied for the long-haul:

1. Competence – make sure people have the rights skills and knowledge to do the job.

2. Care – the extent to which a person actually wants to do a good job;

3. Ethics – do the right thing, even when no-one is watching.

Rinse and repeat.

We need not and should not wait for regulators to act before putting things right.

Some of our members have already taken leadership positions on what they believe to be the root cause of many of the issues uncovered by the Commission – misaligned incentives.

Technology can be our friend when it comes to building credibility and trust.

Technology improves data security – think about how fast banks react when your card gets fraudulently skimmed – technology makes products faster and easier to use, brings access to more and better information to help them understand their finances.

It's interesting that both David Murray and APRA chairman Wayne Byers have recently reminded us about the principle of caveat emptor – let the buyer beware.

Wayne Byers said: "Regulators cannot be everywhere overseeing everything," and that consumers want all the benefits of a "dynamic, innovative financial sector … but no one has any appetite to lose a cent."

However, we have to get the balance right. For wealth management, fiduciary duty underpins our obligation to our customers to put them first.

Productivity Commission:

I want to touch on the Productivity Commission report.

The FSC supports the majority of the Commission's draft recommendations – in particular, its central tenet, decoupling the default system from the industrial relations system, for which we have long advocated.

Karen Chester and her team found that a key driver of poor outcomes is having default funds tied to employers and workplace relations through enterprise agreements and modern awards. They note that this has worked in favour of the funds, not consumers.

The massive number of multiple and “zombie” super accounts the Commission identified – 10 million, or one third of the total – was pretty shocking.

We welcome the PC’s solution, a “default once” mechanism. Untying default superannuation from employers and enabling people to automatically carry that fund from job to job, just like their tax file number, will prevent the account proliferation that is baked into the current industrial relations system. This would work alongside recently introduced government legislation to clean up multiple accounts through consolidation of inactive accounts and those with low balances via an ATO sweep.

As noted by the Commission, the removal of choice for around 800,000 consumers who are locked into superannuation funds through enterprise agreements is also evidence of the anti-competitive nature of the default system. This creates poor outcomes for those members who are locked into subscale, low performing funds.

Raising the bar for APRA MySuper authorisation through additional carefully designed criteria will also be key to improving default outcomes for those people that current system is failing.

We want to see a new modernised superannuation system, which we call Super 2.0 – with greater transparency, better disclosure and strong governance.

When the playing field is level, all funds will be able to compete equally. Poorly performing funds must lift their game and put the interests of consumers first. The best funds, whether retail, industry or corporate, have nothing to fear from competition.

I want to say a few words about performance.

APRA has consistently warned commentators against using APRA data to form simplistic league tables, when the reality is there are multiple and significant variables in demographics, investment profiles and liquidity requirements between super funds. Not to mention the range of definitions of a “balanced” fund.

Last month the Standing Committee on Economics cited APRA deputy chairman Helen Rowell as saying that APRA "would not agree with an assertion that industry funds as a whole outperform retail funds or other segments of the industry as a whole."

The Productivity Commission has gone to a lot of effort to try and compare like with like, however we urge caution on their initial findings on performance and fees. There are genuine anomalies and gaps in the data used by the Commission mainly because there is little consistency in the measures used to try and compare both MySuper products and choice products as like for like.

We share the Commission's underlying goal to have consistent metrics that permit genuine comparisons between funds and provide sound guidance to consumers. Development of such metrics will be critical to the success of key structural reforms being proposed by the Commission .

The FSC is committed to playing a constructive role in this process and working with industry to improve data standards where required.

Best in show:

One of the most controversial proposals in the Productivity Commission report is that the default system be replaced with a list of 10 "best in show" funds.

There is no doubt that the best in show model is superior to the current default model. As well, our members are used to operating in a competitive marketplace and absolutely believe they would achieve a place in a 'best in show' list.

There is however, more work required to understand the potential long-term impact of concentrating a large proportion of contributions into only 10 funds.

- Would this lead to dis-economies of scale? Oversaturation of markets? Would the effect of massive institutional investors on ownership of key infrastructure assets lead to concentration of power and poor consumer outcomes?
- Could a super fund could take over BHP, as the AFR's James Thomson recently reported?

The FSC agrees with the Commission that elevating the threshold for MySuper authorisation should be central to reforming the default system.

Rationalising MySuper products, by increasing the baseline for their quality, could effectively create a "best in show" list of high performing default funds without the need for an additional selection panel process.

Where the FSC will lead:

Retirement Incomes:

Today, 700 Australians left their jobs and retired. Tomorrow there will be another 700 and so on.

As you know, I have been passionate about encouraging young people to engage with their super from the start of their working lives but we need to also think about people who are reaching retirement. One day they're employed for money, the next day, they're on their own. It's binary.

We need to be there at that point when super becomes their salary for the next 20, 30 or even 40 years.

Our members – fund managers, superannuation funds, life insurers and financial advice networks will all be involved in shaping the new world of retirement income solutions with state of the art products and advice.

As a standard setting body focused on delivering strong policy, the FSC, with our members, will ensure that quality parameters are set to address the unmet needs of retirees – both those on the cusp or retirement and those who will retire in the future. I will have more to say about this in the coming months.

Life Insurance:

I am proud to announce our new life insurance industry data project, the culmination of two years of work by the FSC.

This multi-million dollar investment is a strong commitment by our life insurance members to increase transparency and to further enhance consumer outcomes.

It will address what has been one of our major shortcomings - the absence of an industry approach to the collection of aggregate industry data.

The data project will provide the evidence the industry requires to better design the products of the future.

For the first time, armed with a large scale base of reliable statistics, the industry will be able to show how much it pays in claims per impairment, broken down by dollar value and by the number of Australians that receive the benefit.

The vision for the project is that over time, the industry will be able to collect meaningful data from the product development stage through to claim, all done in real time.

I congratulate our life insurance CEOs and their teams - and my team - for staying the course on this challenging but rewarding journey.

I would also like to acknowledge the ongoing support and guidance of APRA and ASIC throughout this process.

Life Code of Practice:

We're proud of our work, with our members, on delivering the Life Insurance Code of Practice. It builds trust for consumers in many ways:

- It is a mandatory Standard for our members;
- It is overseen by an independent body – the Life Code Compliance Committee;
- Sanctions can be administered for breaches; and
- It is written in language consumers can understand

The FSC has also worked collaboratively with colleagues in the Insurance in Superannuation Working Group to produce the Insurance in Superannuation Voluntary Code of Practice, an important step to ensure superannuation consumers benefit from enhanced standards in the provision of life insurance.

The FSC will extend our binding Life Insurance Code of Practice to cover superannuation trustees.

This will be achieved through an additional standalone chapter in the existing Life Insurance Code of Practice.

The current Life Insurance Code of Practice which applies to life insurers will become the first chapter of the new code.

The new second chapter will extend to the FSC's 15 superannuation trustee members which together account for $508 billion across more than 12 million superannuation accounts.

Standard One:

I also want to announce that we have revised our most important mandatory Standard, Standard One, our Code of Ethics and Conduct.

I am very pleased that we were assisted by Dr Simon Longstaff, CEO of the Ethics Centre. I was delighted to hear the Honourable Neville Owen in his keynote address yesterday describe Standard One as an excellent document. The new version is on our website now.

The export opportunity for fund managers:

The Asia Region Funds Passport has finally been legislated, which we welcome.

Exports of Australia's expertise in funds management present a great potential for growth, particularly as Asia's middle class grows. Research done for us by Deloitte Access Economics found that increasing the level of Australia's funds management exports to levels equal to Hong Kong by 2023-4 would support an extra 10,000 jobs in Australia. A doubling of export revenue from funds management exports would result in an increase to GDP of $330 million over the next 10 years.

However for this to work, the government needs to fix our complex and uncompetitive non-residential withholding tax regime. If we don't do this critical piece of micro-economic reform, retail investors in Asia will bypass Australia and head straight to the markets which offer zero withholding tax rates. We urge the Government to follow up their good work in setting up the Passport by fixing the non-resident withholding tax issue.

Finally – we're all here today because we love our industry.

For good reason.

This is a highly regulated sector that has faced wide scale systemic reform that takes time to implement and prove that it is working. For the vast majority of people, it works very well.

And we have hundreds of thousands of great people working for our businesses. We celebrated several of you last night at the Summit dinner during our Excellence Awards – thank you for the extraordinary work you do helping us develop great policy. Apologies, we inadvertently left out two important members of the RG97 team – Georgina Ellens of NAB and Ian Fryer from Chant West.

SLIDE 6 – FAMILY

One of my team was sent this story from the front page of the *Star Weekly* – those of you from Melbourne's western and northern suburbs may have already seen it.

The article details the tremendous support received by a local family from their community after losing their mother and wife to cancer, then their family home to a fire. The father, Stuart, thanks his the Newport Baptist Church, the Bayside Secondary College and Newport Lakes Primary School.

Stuart also says: "I really wanted to say thank you to the bank because it could have gone either way … being here for at least 12 months has provided an element of stability that, particularly with the young children, is absolutely crucial," he said.

As I said before, people take a leap of faith every time they come into touch with one of us and what we do. People don't necessarily want to become financial experts – but they do want to have a trusting relationship with us to help them navigate life's financial complexities – Someone like that suburban bank manager.