State of the Industry
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Introduction

My first day in this role was a Sunday - the day David Murray handed down his landmark Financial System Inquiry report. This was a good introduction to the 24/7 world of financial services.

Do you people ever sleep?

Ladies and Gentlemen
It is a privilege to lead the Financial Services Council at this time.

Five years ago, when my predecessor John Brogden made his first speech in the role, financial services had become the largest sector of the Australian economy, passing mining and manufacturing.

It is still the case today.

Financial services contribute 9 per cent to GDP.
The sector is one of the largest employers in the country, employing more than 400,000 people -

53% of whom are women.

In the past twelve months to September 2014, the sector grew by 6.1 per cent – more than twice the rate of GDP.
The Australian financial services industry manages $2.4 trillion, the third largest pool of contestable funds in the world. Superannuation drives this number.

By the end of this year our superannuation funds will be managing $2 trillion worth of funds. This is the world's 4th largest private pension system behind the US, Japan and the UK.
Over the past two decades superannuation has grown considerably faster than the economy, averaging growth of around 12 per cent a year.

That means that by the time we have finished lunch, superannuation funds under management will have grown by $25 million.

The numbers generated by the financial services sector – funds management businesses; superannuation funds; life insurers; financial advisory networks, licensed trustee companies and public trustees - are not just good for the sector, they are critical to achieving three outcomes for Australians:

- increasing wealth
- protecting lives; and
- providing a comfortable retirement.

The industry is a major contributor to philanthropy**.**

- Financial services companies are responsible for 3 of the 10 largest grant making foundations in Australia and many of our members are leaders in corporate philanthropy
- Trustee members of the FSC act as trustee or co-trustee for more than 2000 charitable trusts or foundations with assets of more than $3 billion.
- And the FSC supports the First Nations Foundation's ground-breaking work in delivering better financial literacy to indigenous communities.

This is something I am determined to help grow.

While the sheer size of the numbers generated by the financial services sector – and the giving back – is impressive, it's timely to reflect on a point made by David Murray's panel: that while the industry contributes significantly to Australia's employment and economic output, the focus of financial system policy should be on the degree of efficiency, resilience and fairness the system achieves in facilitating economic activity.

For instance, it's no good having the cheapest fees for super if returns are sub-optimal. Or allowing states to persist with the inefficient and complex array of stamp duty taxes on the life insurance industry, which add to compliance and costs.

The FSC has some key priorities for 2015 which will contribute to delivering wealth, protection and comfortable retirements for Australians in a fair, resilient and efficient way.
These are:

- Broad and sensible tax reform
- A retirement outcomes system which delivers the best possible standard of living for as many Australians as possible
- An open, efficient and competitive superannuation system
- A sustainable life insurance industry
- Ensuring our world-class funds management industry can capitalise on its natural advantage to export its expertise globally, particularly Asia.

Our view is that Tax reform and a quality national retirement outcomes policy must be considered in tandem.

It's clear from Australia's demographics and the budget that the status quo is no longer an option.

As we wait for the fourth instalment of the Intergenerational Report, the facts from the 2010 Report show that our tax base is eroding rapidly as our population ages.

Back then, it was calculated that the ratio of working aged people relative to retired people will almost halve by 2050, from around 5 in 2010 to just 2.7 by 2050.

Prompted by the Government's pending Tax White Paper, this is a message whose time has come – we now have a strong national debate centred on how our tax system can and must deliver fairer and better outcomes for our aging community.

Many issues are being fiercely contested in the public arena right now, including:

- The family home
- Tax treatment of superannuation
- The pension assets and income tests
- The GST
- Capital gains; and
- Dividend imputation

While these are all tightly held, they do need to be on the table if we are to reform our tax system and ensure it is efficient and effective relative to other countries in the region - our high level of company tax and inefficient state taxes are all reducing Australia's competitiveness as a place to do business**.**

Our broken Federation also reduces accountability due to buck passing between jurisdictions.
A key priority for the FSC is to design a national retirement outcomes policy which utilises some or all of these levers to ensure that we can retire in a more comfortable, stable and secure way than did previous generations.

The entire economy will benefit if our retirees are able to sustain and enjoy higher levels of consumption.

And we have a responsibility to design a national retirement outcomes policy that removes dependency on the public purse.

In light of the current debate you may well ask how can this be achieved.

Let's look at tax treatment of super. It should be on the agenda – but not in isolation.
We know, as an industry, we cannot ignore the equity concerns raised by the community. If we do not address these concerns –as David Murray pointed out - there is a risk the community will lose faith that superannuation is worth the investment they and the government make in it.
But we cannot afford to have a narrow conversation on tax alone – we need to begin with the outcome we want – a sustainable fiscal position and the best possible retirement for the majority of people – take this model, and work back from there.

A sustainable national retirement outcomes policy will not be achieved by targeting tax treatment of superannuation in isolation.

We should never lose sight of the objective of super – it was, is and must remain, the structure designed to deliver a sustainable and comfortable retirement for Australians and reduce reliance on the age pension.

It is not for funding personal debt or to pay off HECS, nor was it designed as a vehicle for intergenerational wealth transfer.

While the industry may have well-developed views on the objectives of superannuation, the community is the key stakeholder in any discussion on the purpose of super.
David Murray made the point in his inquiry that the community does not appear to have a clear idea of the purpose of super.

To test community views, FSC engaged researcher GFK to gauge perspectives on super and the age pension.

Our new research shows that 56 percent of Australians expect to take an aged pension upon retirement.

This is a high ratio when you consider Australia has had almost a quarter of a century of compulsory superannuation which needs to replace the pension.
Encouragingly, the responses to a question on expectations on accessing the age pension differ greatly between older and younger Australians.

67 percent of people in their 60s expect to access the pension.
This compares to:

- 56 percent for those in their 50s
- 43 percent for 40s
- 41 percent for 30s

This significant reduction in expectations shows younger Australians may well be aware of the fiscal reality about to be presented in the Intergenerational Report.
It also shows that younger Australians have a better understanding of superannuation - which is not surprising given people aged around 30 have grown up with super.

When asked about the purpose of super, 63 percent believe that superannuation is designed to "provide a privately funded retirement."

Just 32 percent believe it is to supplement the age pension.
This is why it is essential that we think of superannuation as part of a retirement outcomes policy for the nation.

Our system must maintain favourable tax treatment for all members of superannuation funds to ensure people are incentivised to save – if not, they will invest in other low tax or tax-free vehicles, like the family home.

The contribution rate is too low for super to achieve its goals, and the system is yet to mature.
A reduced flow of savings going into super will further delay our goal of creating an Australia which can fund its own retirement and reduce reliance on the age pension.

Any changes to super tax treatment must be synchronised with changes to the age pension. They cannot be dealt with in isolation.
We need to significantly shift remaining expectations that the age pension is an entitlement which is available to all.

The expectation should be that super is a replacement for the pension, not a top-up, and the age pension needs to be considered as a safety net for those who cannot provide for their own retirement.

The Government needs to consider whether the correct people are receiving the age pension based on their personal wealth.

The income and assets tests for the age pension should be reviewed to ensure it is not too generous for those people who can fund their own retirement, and not miserly for those who cannot. Eligibility rules are too loose. Is it fair or sustainable for a couple who own their own home, who hold an additional $1 million in assets and can receive an income of up to $60,000 per year to still be eligible for a part-pension?

Is it fair for our children to bear the cost of our failure to bite the bullet on this issue?

Preservation Age

A lever that can be pulled in the design of a national retirement outcomes policy is to raise the preservation age of superannuation.

Raising the super preservation age to 65, which better aligns with the pension eligibility age, closes the retirement savings gap significantly.
Of course care would need to be taken to ensure that people who genuinely cannot work to age 65 could access their super earlier.

But raising the super preservation age is broadly a win-win scenario. The net effect would result in people having higher personal savings and spending less time in retirement, reducing pressure on the public purse. Higher levels of mature age workers would significantly benefit the broader economy - and engagement in the workforce for longer is known to lead to better personal outcomes like better mental and physical health.

Our research shows that people do want to work longer if they're fit and able.
Mature workers are the new black. And 65 is the new 50.

In summary - in the context of a full tax debate, which we are looking forward to in the Tax White Paper process, we recognise that tax treatment of super – both in the accumulation and the retirement phases – should be on the agenda.

But the only sensible and sustainable way to achieve outcomes which benefit the majority of Australians will be to look at all elements as part of a holistic tax reform package – including the GST and the age pension eligibility rules and the preservation age, as well as a raft of inefficient state taxes like the stamp duty on life insurance.

So if tax reform leading to a national retirement outcomes system is a top priority, where's the low hanging fruit?

We are still not exploiting our comparative advantages in financial services – particularly in exporting our world-class funds management and financial services expertise.
Mark Johnson's 2009 review, *Australia as a Financial Centre*, is unfinished business.
While there has been good progress of the development of the Asia Region Funds Passport which will provide a regulatory framework for mutual recognition of fund operators and investment funds between participating countries, it remains frustrating that more of his recommended reforms – the investment manager regime, broadening the range of allowable collective investment vehicles, removing tax uncertainty and enabling competitive tax settings - have not yet been delivered.

Taken together these would enable our funds management industry to bolster our entry into the burgeoning Asian markets particularly China, Korea and Japan, with which we have Free Trade Agreements.

There is much to win. Currently the proportion of funds sourced from overseas is less than 5% of the $2.4 trillion in assets managed here in Australia. While this has been growing and delivering significant benefits to the economy, there is the potential for an exponential increase in foreign sourced funds with the right policy settings. This would include the Johnson recommendations, and the reduction of withholding tax to 5% from its current setting of 15% for Asia Region Passport participants.

As resources prices fall and manufacturing continues to decline, Australia must find more exports - and financial services are in pole position.

We believe Johnson's reforms would have bipartisan support. Their completion and delivery must be a priority.

To quote Mark Johnson – "If you fail to persist with a reform agenda in financial services you never scrape the barnacles off the boat of industry."

Turning to the FSI Report.

David Murray identified some significant reforms the Financial Services Council strongly advocates. The first is a recommendation to establish and codify a set of objectives for superannuation that have broad community support.

The next is governance of super funds **-** to align superannuation fund governance with international best practice by requiring superannuation board trustees to have a majority of independent directors and an independent chair.

It is the standard to which we hold our members and it should be applied across all super funds in the industry.

It is consistent with all other APRA regulated sectors and aligns with the ASX Corporate Governance Principles. It's the gold standard in any governance framework - listed companies, banks, ADI's and life insurance companies - super should be no different.

We know transitioning super boards to independence is not easy.

But the outcomes, including prevention of related party conflicts and increased diversity, are worth it.

Default Superannuation
Mr Murray put choice and competition at the centre of his recommendations on superannuation, strongly endorsing the principle of a consumer's right to choose their fund in a compulsory system. He recommends that all individuals be allowed to choose their superannuation fund.

This is an important reform, as many people covered by enterprise agreements and awards must use the fund chosen for them regardless of whether or not they are a member of a trade union.
Our view is that all employers should have the capacity to choose any MySuper product to be the default fund for their workplace – and all employees should be able to exercise choice of fund in enterprise agreements.

If Australians are forced to save a portion of their salary for 40 to 50 years they must be allowed to decide who will be the custodian of their money.
When it comes to fees, we disagree with the FSI's assessment that fees in the superannuation industry are 1.2 per cent on average. Research by Chant West shows fees in MySuper have dropped to 0.85 per cent.

While fees in default superannuation are already low, choice and competition can drive them lower. MySuper is working and needs to be given time to further improve efficiency, but it requires an open and competitive market to do so.

The Financial Services Council wants to see the superannuation system decoupled from the industrial system – this means opening up the default superannuation market to retail MySuper products so they can compete with industry funds; and it means removing the Fair Work Commission from the fund selection process.

The MySuper default sector already has a quality filter.

APRA approves MySuper products as meeting the legal consumer protection and performance requirements which are expected of a default superannuation fund.

By allowing all APRA approved MySuper funds to compete for default superannuation in an open market, competition will be achieved and fees can be driven lower.

Life insurance is another area of reform the FSC is currently leading.
In the wake of an ASIC Review of Retail Life Insurance Advice last October the FSC and the Association of Financial Advisers set up a process to review the ASIC report and present durable solutions to the issues raised.

We commissioned an independent chair, former APRA Member John Trowbridge - who, after receiving almost 140 submissions - will deliver his findings in late March. One thing is certain – the status quo is not an option.

Our national wellbeing benefits from a quality, sustainable and innovative life insurance industry. When people have the right cover and quality advice, they can be properly protected when they most need it.

A sustainable life insurance sector will be critical in addressing many of the issues raised by the Intergenerational report. A healthy private insurance sector vested with community trust is required – and particularly by as our society ages.

To this end, the FSC is examining the role the life insurance industry could play in reducing the future costs to government of the National Disability Insurance Scheme and the Disability Support Pension. Income protection insurance that protects against the economic risks of disability is an underused policy device in Australia, which could reduce Commonwealth budget pressure arising from increasing disability-related welfare costs.

Just as superannuation is the private sector solution to the costs of an ageing population and private health insurance is a private sector solution to managing health care costs, so too life insurance can be the private sector solution to the increasing budget costs of welfare.

As a long-time governor of the Cerebral Palsy Alliance Research Foundation, I have a deep commitment to the disability sector. I support and value the NDIS which I truly believe will be an enormous force for good – but there are concerns about its long-term sustainability.

To demonstrate the costs that could be saved by privatising a portion of the NDIS, which is not means tested, and the Disability Support Pension, FSC engaged Deloitte Access Economics to construct an alternative policy design which utilised income protection insurance.

By using incentives and disincentives, the modelling shows that improving the level of private disability coverage could generate net savings of $8.5 billion.

Turning to advice.
The advice industry as we know it today must –and is – being transformed, thanks to several recent major reviews which have left no doubt as to what needs to change.

The advice sector has been under intense scrutiny. The game has changed. Structures have been and are still being built to achieve reform and protect consumer interests.
It is imperative that Australians can trust the system to ensure they get the quality advice and products they need to build secure futures.

The FSC supports reforms which will deliver higher standards for financial advisers and the advice sector. There is bipartisan support for the ASIC register, national exams, university degrees and an adherence to a code of ethics. The bar is being raised.
The sector will evolve into a profession– as it must.

Finally
Like many of you, I've been a close watcher of the political scene for decades, cutting my teeth as a reporter in Joh Bjelke-Petersen's Queensland.

His was a government that had endured for more than 30 years – which is dog years in today's political cycle.

This political climate is the most febrile in living memory. Governing is hard slog all over the world. Short human attention spans and social media means that every minute tic in the body politic is examined, and not always in a sensible way.

Taking the initiative, launching difficult or unpopular reform which on any reasonable measure could enhance the national good, is risky business for governments of any stripe.

Finding solutions is hard work. There is rarely a silver bullet. And ironically, as attention spans have reduced, issues have become more complex.

It becomes more difficult for people of goodwill to find a channel with the bandwidth required to explain complex problems. This is something that applies not only to politicians, it applies to our legal and tax systems, and of course it also applies to a huge range of business issues, particularly in the financial services sector.

We don't have all the answers but what we do know is that our industry is heading in the right direction. Financial services is one of the industries that will drive Australia in the future, as an employer, an exporter and a contributor to economic growth.

It's my personal belief that as business leaders we have a responsibility to assist and support those genuine and courageous politicians and public officials - and there are many - who are demonstrating courage and leadership to find proper consultative solutions in these difficult and fragile times.

As leaders in the industry that contributes most to the national economy and whose products and services touch the lives of every Australian, finding the solutions and leading reform to deliver better outcomes for all is also our responsibility.

Thank you.

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