CHECK AGAINST DELIVERY

**STATE OF THE INDUSTRY SPEECH**

**Sally Loane, CEO, Financial Services Council**

**26 February 2016**

Good afternoon Ladies and Gentlemen. It is a privilege to be speaking to you today at our State of the Industry Lunch.

I would like to welcome our new sponsors Henry Davis York, especially Investment Funds and Financial Services Partner Nikki Bentley and the HDY team.

I would also like to welcome FSC Chairman Greg Cooper, Deputy Chair Brad Cooper and Director Lochiel Crafter.

And welcome to our members right across financial services.

I would also like to acknowledge and pay my respects to the traditional owners of the land on which we meet – the Gadigal people of the Eora Nation.

**2016 is a very important year, both in Canberra and for the financial services industry.**

It is an election year - and while tax is at the centre of the policy debate, we hope this will not be a superannuation election.

To be specific, a "tax on super" election is the last thing Australian savers want.
For several months there has been an intense national debate on superannuation – all aspects of it – from taxing it, to the imperative for critical reforms including stronger governance standards, choice and competition.

The news cycle has been dominated by tax and superannuation speculation.

Finance journalist Robert Gottliebsen recently wrote: "Whether the 2016 election is held in the next few months or later in the year, it will be the first election for decades in which superannuation, lump sums and savings policy are major issues."

**There has never been a more exciting time to be in financial services.**

It gets even more exciting. Today I'm launching the 2016 FSC-UBS State of the Industry Report which confirms that financial services is now Australia's largest industry. Let me start with some facts.

**STATE OF THE INDUSTRY REPORT**

Financial services is Australia's biggest sector – larger than mining and manufacturing.
The FSC UBS State of the Industry Report confirms that financial services has outstripped all other sectors to become Australia's fastest growing industry over the past two decades.

- In the 12 months to 30 September 2015, the contribution of the financial services sector to the Australian economy was $141 billion, or $5,881 for every Australian.

- The industry employs 451,000 Australians – 48 per cent male and 52 per cent female.

- Employment in financial services is concentrated on Australia's east coast with Sydney the largest employment centre.
- In the 12 months to September 2015, the sector grew by 4.82% per cent – twice the rate of GDP.

- The Australian financial services industry manages $2.6 trillion, the third largest pool of contestable funds in the world.

The importance of financial services is not just a measure of its contribution to employment and to the economy more broadly, but also its role in delivering integration and efficiency in services and products which increase the wealth of Australians, protect their lives and provide comfortable retirements.

**The $2 trillion superannuation sector** underpins Australia's financial services industry.
There are 245 APRA regulated funds and more than 560,000 self-managed super funds.
Superannuation is our only truly intergenerational public policy, designed to enable us to save for our retirements and relieve the growing pressure on the age pension.

**Australia's 28 life insurance companies** account for $44.2 billion.
They play an important role in protecting the livelihoods of Australians in the event of serious illness, death or disability. Most people can get insurance cover for life and total and permanent disability via their superannuation funds.

The life insurance industry has made significant progress in bedding down various reforms and legislation has been introduced to Parliament amending the Corporations Act.

An industry Code of Practice will be announced mid-year.
These are positive developments which will significantly strengthen consumer confidence in the sector.

**Funds management** is another important part of financial services.
This ecosystem, with its $2.6 trillion funds under management, has enabled the development of expert and innovative asset and fund managers; a world-leading governance and regulatory system and highly competitive markets.

Australia's volume of financial services exports – overseas investors putting funds into Australian managed investment trusts, as measured by our annual FSC Perpetual Australian Investment Managers Cross-Border Flows Report – has more than doubled over the past five years and now sits at $43.6 billion.

However, at 3.5 per cent, these exports remain small as a proportion of total funds under management.

If we are to fulfil our potential in funds management exports and become truly competitive on the global scene, the Government must simplify Australia's withholding tax regime, introduce competitive rates, and broaden the range of collective investment vehicles on offer.
We have called on the Government to include these urgently needed reforms in the May Budget.

**Financial Advice** is on track to transform into a profession. There are just over 23,000 financial advisers and more than 1300 Australian Financial Services Licensees in the sector. We support legislation to strengthen adviser standards, including via a relevant degree, exam and professional year, supported by continuing professional development and a code of ethics . This will be introduced into Parliament very soon.

Like the life insurance reforms, a very positive development which will strengthen consumer confidence in the sector.

**Our member Trustee companies** – private and public - play an important role in providing services to individuals, not-for-profits and the corporate sector which include philanthropic advice, complex estate planning, disability trust management, acting as trustee for corporate transactions, and helping Indigenous communities to maximise the opportunities offered by native title.
Australia has 1500 charitable trusts which have a market capitalisation of $4.37 billion.

That's the current State of our Industry. A nice set of numbers. The reports are on your tables and I commend them to you.

**Let's turn to the issue of the week, day and hour. SUPERANNUATION.**
In a week where the volume of speculation and uncertainty about superannuation has reached what I'd call peak super, I'm going to focus on why we need to pay attention.
I'll outline why we have super, what it is doing and what we need to do to make it a sustainable, effective policy as our society ages and our tax base is cut almost in half in the coming decades.

I want to build a strong case for cool heads to prevail in the sometimes febrile debate on tax and superannuation.

Superannuation is our only truly intergenerational public policy, the purpose of which is to provide adequate self-funded retirement incomes for all of us, and equally importantly, to reduce pressure on the age pension system, which at $44.7 billion a year and rising at a rate of seven percent annually, already consumes 10 percent of the Federal Budget.

For a policy that is only 24 years old, there is a lot of amnesia about what superannuation is for.

Both major parties appear to be looking at ways to tax Australia's superannuation savers.
**Labor has announced its policy** – it will increase the contributions tax from 15 to 30 per cent for those with an income over $250 000 per annum and levy a tax on investment income over $75 000 per annum when an individual is in retirement. Quite a lot more tax on superannuation.

**The Government**, in spite of promises made before the last election to stop tinkering with super, appears to be considering doing just that.

In a speech to last week's SMSF Association conference, the Treasurer said the Government would have to make, and I quote: "Hard decisions when addressing the targeting of tax concessions."
While the Government hasn't yet given us any firm plans, there has been much discussion in the public arena about tax "progressivity" and new concession caps - with various models being fed into the debate – some of them extremely detrimental to Australians retirement savings.
One in particular would reduce super contributions to a vestige – the "why bother" option.

**Kites have been flying in the media.**

Last Sunday, there was one to give low income earners the chance to "opt out" of superannuation. This is a very poor idea. It undermines the fundamentals of the system. If one group is allowed to opt out, who will be next?

It would be the thin edge of the wedge for other wholesale changes to our super system.
It would have a material impact on many Australians.

Some impacts may not be immediately obvious but could be devastating. For instance, what happens to insurance coverage for low income earners who no longer have group coverage in compulsory super?

The Government did rule this out - good news.

Another, again thankfully knocked down fairly quickly by the Government, was one to permanently freeze the Superannuation Guarantee rate at 9.5 per cent.  Again, poor policy which would defeat the purpose of super.

The only way we are going to get a critical mass of self-funded retirees independent of age pension reliance is to get the Superannuation Guarantee to 12 per cent as soon possible. The Government has this set for 2025 – we urge them to bring it in sooner, by 2022 at the latest.

Just on the SG, can I commend FSC member Perpetual for announcing at Results this week that it lifted the rate to 10 per cent for employees and would raise it to 12 per cent by 2020.
CEO Geoff Lloyd said this was to demonstrate the company's commitment to adequacy – a great move and one that deserves many followers.

Wednesday's news cycle was dominated by a kite flown on Capital Gains Tax for super funds – in other words, tax on investments inside super.

Once again – this is a bad idea which would erode savings.

Trustees of APRA regulated funds already have a lower discount than individuals - 33 per cent Compared to 50 per cent. If the discount was reduced further to 15 per cent, investment decisions could potentially be distorted and existing investments adversely affected.

Any proposal to change CGT on investments inside super funds ignores the tax complexity surrounding the transition from accumulation to retirement phases.

All the reviews into superannuation over the past decade – the Cooper Review, the Financial System Inquiry and the Productivity Commission reviews – have focused on how to boost returns to consumers after fees and taxes.

Increasing Capital Gains Tax on money already invested in super effectively puts the brakes on growth of invested savings and, over time, would have a material impact on the compound growth of a member's balance.

It runs contrary to all the hard work and reform implemented already.

Yesterday's media story claimed the Government is considering a cut to concessional caps to $20,000.

Again this is poor policy. The concessional caps have been lowered significantly already, at $30,000 for most taxpayers and $35,000 for those over 50. Any move to bring this down to $20,000 will particularly penalise older workers who are trying hard to save more in their last decade or so of work. Like other tinkering options it pushes the goal of self-funded retirements for middle Australia further into the future and condemns future generations to higher taxation to support them.

**The question we all need to ask is – why tinker with superannuation?**
**What is the problem we are trying to solve?**

Tinkering is a bad idea in itself – it immediately creates more uncertainty and less confidence in the system.

In his speech last week the Treasurer asked the question. He said: "Should we direct tax concessions to superannuation in the same way we are doing it now, or should we instead put more money towards reducing income tax or company tax?" "Is there a better balance we should strike?"
I would suggest that the question that needs to be asked is not about tax - it should instead be: "How do we get people to save?"

The national retirement savings policy – otherwise known as superannuation, has little to do with the tax system.

Everyone knows we have a crook tax system. It is confusing, inefficient, costs Australia investment and jobs and it reduces the incentives for many to work.

**You can tinker with super but the truth is you will still have a broken tax system.**

Superannuation changes are not credible tax reform. A credible tax reform is a tax mix switch. But that is a debate for another day. Let's be very clear, the gates have long been closed to stop people stuffing millions into super.
Super was never designed as an intergenerational wealth transfer vehicle and should not be used as such.

We have consistently said that in the effort to design a better retirement system, the tax treatment of superannuation should be on the table – but that it must be considered in the context of a full retirement income review that includes the Superannuation Guarantee rate, aged care affordability, the age pension entitlement and the assets and income test, as well as access ages for the pension and for super.

Super must not be raided to fill Budget holes or fund pet projects.
Early this year, the FSC released PwC modelling on several progressive tax options being debated in the public arena. We did this to highlight what each option would mean for Australian's retirement savings.

The results were striking.

The policy given the greatest attention at the time - an option to apply a 15 per cent rebate on marginal tax rates – was shown to undermine the retirement outcomes for middle and lower Australia – people earning $80,000 or lower, that is, 80 per cent of Australians.
The FSC does not support the 15 per cent rebate model. This proposal would send the retirement savings of middle Australia backwards and condemn them to higher levels of reliance on the age pension.

The only option which did not harm the savings of middle Australia was when the superannuation guarantee rate was raised to 12 per cent, and any discount on the marginal tax rate was at least 20 percent.

This model is revenue neutral – no money would be taken from super and transferred into consolidated revenue.

If the Government does have plans to change super, we urge it to find options that increase, not deplete, savings for middle Australia and crucially, do not add implementation costs onto super funds and therefore upward pressure on fees.

Superannuation can be made more sustainable so it can deliver on its long-term purpose.
**When making the case for a great superannuation system, we need to turn to the intergenerational report.**

The great weight of demography is bearing down. The baby-boomers are retiring – 700 Australians are turning 65 every day:

- Life expectancy for Australians is among the highest in the world. By 2055, men will be living to 95 and women till 96.6.
- In 2055, there will be 40,000 people aged over 100. In the mid-70s there were only 122 Australian centenarians.
- By 2055 the number of working Australians aged between 15 and 64 for every retiree over 65 will be just 2.7 – nearly half what it is today, 4.5 people. In simple terms, the numbers of working taxpayers will be reduced by almost half.
- By 2055, the participation rate for Australians aged 15 years and over is projected to fall to 62.4 per cent, compared with 64.6 per cent in 2014-15.
- A lower proportion of Australians working will mean lower economic growth over the period.

We know these facts. Survey after survey has found that too many Australians, in fact more than half in a last week's ANU survey, are concerned about not having enough savings for their retirement.

Research commissioned for the FSC shows that if we don't save more for our retirements, almost 80 per cent of us will still be reliant on the age pension in 2055.

That doesn't seem to be great result after what will be more than 60 years of compulsory saving.

1. **HISTORY OF THE SUPER SYSTEM**

**In the context of this election year I want to touch briefly on the history of superannuation and do a stocktake of the system.**

Superannuation savings and the age pension have a long history in Australia.
The first age pensions were paid in New South Wales in 1900 and nine years later a national system replaced state schemes.

These were modest and means tested, around 12 per cent of male total average weekly earnings.
Today the age pension is benchmarked at 27.7% of male total average weekly earnings.
Superannuation savings used to be entirely voluntary. Tax concessions were introduced in 1915 - deductibility for employer contributions and a tax exemption for super fund earnings.
In 1992 the third pillar of Australia's retirement system – the national compulsory superannuation system - was introduced by then Prime Minister Paul Keating.

At the time, it covered 72% of workers. It was a deal to give employees a non-inflationary wage rise, but had a good policy outcome. It responded to the challenge being faced by most advanced economies in the world – an ageing population and a diminishing workforce. Compulsory retirement savings would take the pressure off Australia's age pension.

In 1997 the Wallis Inquiry into financial services examined the fledgling super system, which then only managed $300 billion - the SG rate was six per cent.
In 2014 David Murray's Financial System Inquiry re-examined superannuation.
In the 18 years between the Wallis and Murray Inquiries there was significant growth in the system, primarily due to the increase in the Superannuation Guarantee rate to 9.5%, as well as strong non-concessional contributions and investment returns. As we know the system now manages $2 trillion.

2. **STOCKTAKE**

**So where are we now?**

Is super working? What benefits has it brought to the Australian economy over the last 24 years?
Let's start with Australia's savings rate. Our gross saving rate fell significantly from the mid‑1970s, reaching a low of 18.4 per cent in 1991‑92. It remained steady at 21 per cent then began to rise in 2005.

By 2011, the national savings rate had risen to 24.8 per cent – significantly above the advanced economy average of 18.5%.

Our compulsory super system is a key structural driver of this savings rate.
As we know, this stock of national savings provided a significant buffer for Australia's economy during the Global Financial Crisis. Our three pillar retirement system - the budget funded age pension, compulsory savings through the superannuation guarantee, and voluntary savings - is unique among developed countries.

Dr Ken Henry in his 2009 Future Tax System Review, wrote: "Australia's three pillar system 'provides a system that satisfies the needs of all older Australians, provides the capacity for individuals to enhance their retirement income, and spreads risks between the public and private sectors in a fiscally responsible way."

There are forecasts that super funds will grow to at least $8 trillion over the next 20 years - firmly establishing the system as structurally important to Australian household's financial wellbeing. Superannuation currently saves the Government, and taxpayers, more than $7 billion every year on age pension expenditure.

It generates almost $11 billion in annual tax revenue for the Federal Budget.
The superannuation system also enjoys an extraordinary level of public support.

Recent research for the FSC and ING Direct shows that 88 per cent of working Australians support compulsory super and 81 per cent say it's essential for a comfortable retirement.

This system has lifted the retirement savings of all Australians. It has helped to buffer the prospective deterioration in our budget finances as our population ages by reducing reliance on the aged pension.

**But has super achieved its objectives?** The answer is not yet.

There are other positive changes we can make to improve the system and protect Australia against the cost of an ageing population.

**3. IMPROVING THE SYSTEM**

**Short term**

The superannuation industry has grown considerably over the last two decades, and has been forced to evolve and mature. This has not always been an easy process. The system still has vestiges of its cottage industry past, including a protected default system which is not yet open to market competition.

There are still hundreds of thousands of Australians working under enterprise agreements who remain locked out of choosing their own super fund. There are a number of subscale superannuation funds.

The Government's planned reforms on governance, choice and open market competition in superannuation are the right measures to ensure that consumers are adequately protected and enjoy the benefits of competition.

**Long term**

**Australia's superannuation system has recently been rated by the Melbourne Mercer Index as the world's third best.**

But to be the best, it needs more.

Its purpose - to raise standards of living in retirement and reduce the cost of an ageing population – must be defined and enshrined in legislation. In the 24 years since the introduction of compulsory super, no government – Labor or Coalition – has done this.

Over the longer term, the marker of whether super is working, is if we have a lower overall reliance on the age pension. The projected 80 per cent of people taking a pension after almost 60 years of compulsory super does not pass the credibility test.

We need to increase our savings rates – both compulsory and voluntary - with a view to getting pension reliance down.

Taxpayer support for super must be consistent with the objective of more of us being able to independently fund our retirements.

We should focus on middle Australia – the bulk of the population, and those with the greatest capacity to reduce their reliance on the age pension.

Super can be improved, at no cost to the Commonwealth, to ensure the sustainability of the system and deliver higher retirement incomes for the majority of Australians.

**We urge the Government to adopt our six point plan for super:**

1. Give every Australian saver cast-iron confidence in the system. Take it out of the Budget cycle, stop the tinkering;
2. Define its purpose and make it law;
3. Increase the superannuation guarantee rate to 12 per cent by 2022;
4. Encourage people to save voluntarily beyond the 12 per cent guarantee – by maintaining contribution caps that are high enough to allow women and carers in particular to catch up on their savings after breaks from the workforce. We recognise an additional three per cent would get the majority of people to self-sufficiency;
5. Provide tax concessions which give all Australians – most particularly middle and lower earners - an incentive to save; and
6. Increase the preservation age in line with increases in the age pension and life expectancy.

**If we follow this plan, new analysis by Rice Warner Actuaries demonstrates that the super system will achieve its objective - the present value of our age pension liabilities will be reduced by 60 per cent for middle Australia by 2050.**

By cushioning future generations against the cost of an aging population, it is more likely the living standards we enjoy today will also be enjoyed by our children.

This is why we must take a long term view of any superannuation policy announced in coming months.

Thank you