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Financial System Inquiry

SPAA Response to the FSI Interim Report.

SMSF Professionals' Association of Australia

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About SPAA

SPAA is the peak professional body representing the $558 billion SMSF sector throughout Australia. SPAA represents professionals, irrespective of their personal membership and professional affiliations, who provide advice to individuals aspiring to higher levels of participation in the management of their superannuation savings. Membership of SPAA is principally accountants, auditors, lawyers, financial planners and other professionals such as actuaries.

SPAA is committed to raising the standard of professional advice and conduct in the SMSF sector by working proactively with Government and the industry. In doing so, SPAA has contributed to SMSF advisors providing a higher standard of advice to SMSF trustees. This in turn has enabled trustees to make more informed decisions addressing the adequacy, sustainability and longevity of their own retirement savings. SMSFs offer trustees greater control and flexibility and have become an integral part of the Australian Superannuation landscape by providing significant and viable options for managers, business owners, executives and retail operators alike.

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Executive Summary

The SMSF Professionals' Association of Australia (SPAA) welcomes the opportunity to make a submission in response to the Financial System Inquiry's (FSI) Interim Report (the Interim Report). As leaders of the self-managed superannuation fund (SMSF) industry, we have responded to the key issues that the Interim Report has raised affecting Australia's SMSF sector and the broader superannuation sector. We have focussed on issues where we best believed we could assist and inform the FSI Panel's work going forward.

Self-Managed Superannuation Funds

The SMSF sector is well-functioning, efficient and allowing a large number of Australians to meet their retirement income goals. SMSFs are essential to providing consumer choice and competition within superannuation and have been critical in increasing Australians' engagement with their retirement savings. SPAA rejects calls to further regulate the SMSF sector, especially when these calls are based on anecdotal evidence and self-interest.

SPAA believes that there is no need for concern regarding the operating expenses of SMSFs (page 7). There are a wide range of service offers to SMSFs which allows SMSF trustees to reduce operating costs and select administration offers fit for their purpose.

We also do not believe that there any needs for limiting the establishment of SMSFs (page 11). Minimum balance restrictions would inhibit choice and competition within superannuation. Also, SPAA does not see the need for compulsory SMSF trustee education, as it is best left to trustees to judge what their education needs are.

Superannuation Policy Stability

SPAA supports the Panel's observation that the lack of stability in superannuation policy settings undermines consumer confidence and trust in the superannuation system (page 15). Changes to superannuation should be made with a long-term policy view and not with short-term fiscal goals in mind.

SPAA has proposed the Government and superannuation industry develop an overarching retirement income goal for superannuation to provide stability to superannuation policy making (page 16). Also, we suggest that any significant changes to superannuation be made as part of the Intergenerational Report process rather than on an ad-hoc basis (page 17).

In regards to superannuation tax settings, we caution any generalisations made about superannuation tax concessions and dividend imputation (pages 21-23).

Superannuation and Leverage

SPAA views current lending arrangements used by SMSFs as being used in a responsible manner (page 24). SPAA has recently issued best practice guidelines on SMSF borrowing to guide the market. We also reiterate the need for borrowing arrangements to be a licenced financial product and suggest limiting the use of personal guarantees and tightening related party borrowings to maintain the integrity of SMSF borrowing (pages 27-29).

Retirement Income

SPAA considers the retirement phase of superannuation to be developed to a satisfactory level but recognises that there is scope for further development (page 30).

We believe that it is important to avoid jumping to a conclusion that the solution to further development of the retirement income system is only through product development. In particular, we note the success of the SMSF sector in providing retirement income through account based pensions and support further development of underlying assets to assist in the management of retirement income and longevity risk.

Improving the quality of financial advice regarding retirement income is an important step to strengthening retirement income outcomes (page 34). We support removing impediments to retirement income product development but any such changes must maintain neutrality across all retirement income products to promote competition and efficiency.

We support and propose coherent retirement income, social security and tax settings to provide incentives for retirees to draw down on their retirement savings in a sensible manner while maintaining product neutrality (page 35). We prefer this approach to default options or mandating that pushes retirees into using specific retirement income products (pages 35-40).

Financial Advice

SPAA supports improving the quality of financial advice through improved standards of training and education for financial advisers (page 45). We propose that greater professionalism in financial advice be promoted through a co-regulatory model in preference to the current regulation of financial advisers, and note the emergence of the SMSF profession (page 46).

We support greater clarity regarding independence of financial advisers for consumers to be more informed (page 56) and support removing the existing "general advice" category from financial advice regulation (page 57).

Funding

We note the significant role that the $558 billion SMSF sector will play in funding Australian investment in the future and note the importance of removing barriers to opening up infrastructure and corporate bond investments to SMSF trustees (page 60).

Consumer Loss and Compensation

SPAA has advocated and continues to advocate for a last resort compensation scheme for the financial services sector (page 65).

Regulatory Architecture

The existing regulatory structure for SMSFs under the Australian Taxation Office is working well and does need to be changed (page 69). Refinements to the activities of Australia's regulators could be made to enhance their capacity for quality regulation, including reviewing the regulation of completion and consumer protection in financial services (page 76).

Self-managed superannuation funds

SPAA is pleased that the Inquiry has acknowledged the importance of the SMSF sector in delivering greater flexibility and control, choice and competition to the superannuation sector.

The SMSF sector is achieving the goals of the Australian retirement income system by providing an efficient accumulation vehicle that allows SMSF members to build their retirement savings in a manner that suits their needs and preferences. Also, the SMSF sector is successfully providing retirement incomes with a high percentage of SMSF trustees in retirement phase drawing an income stream from their SMSF. Also, SPAA research has shown that for SMSF trustees managing the transition from accumulation phase to retirement phase is a key motivation in setting up an SMSF and that superannuation income streams make up the largest component of retirement income for SMSF trustees (ranking 7.2 out of 10 in terms of importance for their overall retirement income funding).[1]

Further, we note that the SMSF sector has a high degree of gender neutrality with 47.1% of SMSF members being female. SPAA research has shown that female SMSF trustees are more likely to contribute extra to their superannuation and be engaged with their retirement income than female non-SMSF trustees. Accordingly, we believe that the SMSF sector offers an excellent opportunity for women to be engaged with their superannuation and address broken work patterns and its effects on adequate retirement savings.

Accordingly, SMSFs are playing a leading role in achieving the goals set for the Australian retirement income system.

The Inquiry seeks further information on the following areas:

- To what extent should the Inquiry be concerned about the high operating expenses of many SMSFs?
- Should there be any limitations on the establishment of SMSFs?

To what extent should the Inquiry be concerned about the high operating expenses of many SMSFs?

SPAA believes that the Inquiry does not need to be concerned by the operating expenses of SMSFs.

SPAA acknowledges that some SMSFs with low balances can have higher operating costs, however, these high operating cost ratios generally diminish as funds accrue greater funds

[1] SPAA/Russell Investments, Intimate with Self-Managed Superannuation 2013.

under management. In addition, SPAA believes that SMSF administration costs are steadily falling as competition for SMSF administration clients has intensified by administrators and as technological innovation has made SMSF administration cheaper. Similarly, competition and technology has reduced SMSF audit fees, further reducing the cost of running an SMSF.

A recent review by SPAA of SMSF administration costs revealed that SMSF trustees have a broad range of service options they can choose from for the setup and administration of their SMSF. These offerings ranged from one-off establishment services, bundled establishment and administration services, standalone administration services, and full service packages which include establishment, administration and annual audit fees. The fees across these different service options varied with low-cost options available in all categories of service.

For instance, we have found the following statistical data in our research relating to the cost to set-up a SMSF online and the cost of administration of a SMSF:

SMSF setup

Across 16 providers, the lowest cost was $88 and the highest was $440. This gave an average of $238.09 and a median of $192.50. This demonstrates that the cost to set-up a SMSF is considerably low and not as inflated as some people are led to believe.

SMSF administration

Across 42 providers, the lowest administration cost was $468 and the highest was $3,840. This gave an average of $1,692 and a median of $1,643. In the 2011-2012 year, according to Australian Taxation Office (ATO) data[2], the largest proportion of SMSFs had an asset range between $200,000 and $500,000 (25.56%) compared to the other asset value ranges. The average of the $200,000 to $500,000 band is $350,000. The average administration cost of a SMSF of $1692 on an average fund balance of $350,000, represents a mere 0.48% of the fund balance. This cost is significantly low.

Even on a fund balance of $50,000 (of which only 6.7% of all SMSFs fell into the $0-$50,000 band in the 2011-2012 year according to ATO data), the administration cost of $1692 represents a mere 3.38% cost with respect to the fund balance. However, if a SMSF with a balance of $50,000 had the minimum administration costs ($468), this would lower their operating expense ratio to 0.94%. It is evident that SMSF trustees with low fund balances can maintain competitive operating cost ratios when compared to larger SMSFs and Australian Prudential Regulation Authority (APRA)-regulated funds (especially, where they have simple investment holdings).

[2] ATO, Self-managed super fund statistical report – March 2014 https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Quarterly-reports/Self-managed-super-fund-statistical-report---March-2014/?page=2#Total_asset_range_table

Generally, administration costs correlate with the complexity of an SMSF's asset holdings and investment strategies. Accordingly, SMSFs established with low balances and simple asset holdings can choose from a range of competitive service providers to minimise their fees.

Further, the establishment of an SMSF with a low balance which may incur a higher operating cost ratio is a choice of a consumer. SPAA believes that this is no different to a superannuation fund member choosing to stay with an industry, retail or corporate fund with a higher than average operating cost ratio when transferring their benefit to an SMSF may be a cheaper option. Additionally, SMSFs can be established with a relatively low initial balance in anticipation of significant contributions in the next two to three years (concessional or non-concessional). This allows them to acquire a larger account balance in short period, shifting their operating expense ratio after they were set up with a small balance.

Also, cost is only one factor in establishing an SMSF. Trustee/members may opt to establish an SMSF for greater control over their retirement savings which provides access to different investment options and for greater flexibility in how retirement savings are managed.

Accordingly, SMSF trustees may opt to establish an SMSF even though it may be more expensive than an APRA-regulated superannuation fund while they have a low balance to access the other benefits of SMSFs.

The Panel's commentary on SMSF expenses notes that Rice Warner report commissioned by ASIC, "*Costs of operating SMSFs*" and uses its findings to suggest that "a SMSF requires a balance between $200,000 and $500,000, depending on how much work trustees outsource, to achieve equivalent costs to APRA-regulated fund." SPAA contests the validity and currency of the Rice Warner results and the resulting "break even" conclusions.

The administrative costs referenced in the Rice Warner report seem to be generally in line with what we expect, however, the estimated operating expenses and the resulting breakeven points compared to APRA-regulated funds are higher than expected, especially for higher balance funds.

When compared to ATO SMSF statistics in "Self-managed super funds: A statistical overview 2011-12" the Rice Warner report finds the operating expense ratio of SMSFs to be higher than expected. The ATO data showed that the majority of SMSFs had an estimated operating expense ratio of 1% or less (65% of SMSFs in 2012), the highest proportion (41%) of which had an estimated operating expense ratio of 0.25% or less. This is substantially different to the operating expenses for SMSFs calculated in the Rice Warner report.

The higher cost figure calculated by Rice Warner leads to higher balances in SMSFs being required to achieve a breakeven point against APRA-regulated fund costs for superannuation fund members, as suggested in the Interim Report. As these breakeven points are highly dependent on the operating costs estimated for SMSFs – which heavily depend on the underlying assumptions as to administrators' costs and fund asset holdings - the breakeven points should not be regarded as conclusive figures on which potential SMSF trustees should make decisions.

SPAA also notes some other concerns generally with data and research used to assert that SMSFs have high operating costs. These include:

- ATO SMSF cost data is obtained through the SMSF Annual Return which can inaccurately portray SMSF costs where trustees do not have accurate cost figures as of 30 June of the relevant income year.
- ATO SMSF cost data is distorted by new funds that lodge an SMSF Annual Return in their first year of existence. These funds can often have low balances but attribute initial SMSF setup and advice fees to these funds. This distorts the average SMSF costs for low-balance funds.
- SPAA research shows that SMSF trustees access professional advice on an average of 9.5 times per year.[3] These advice costs are included in ATO calculations and skew SMSF costs compared to APRA-regulated superannuation fund members, whose advice costs do not form part of their fund's operating expenses.
- Other research has not accurately quantified the cost of SMSF advice and have crudely uplifted SMSF expense ratios by between 0.05% and 0.07% to account for advice costs.

We believe that the individual nature of SMSFs and the diverse administration offerings and costs of SMSF administrators, as well as the different approaches of SMSF trustee to the degree of self-administration and outsourcing they undertake for their SMSF makes it difficult to find meaningful average SMSF operating cost ratios and breakeven comparison points with APRA-regulated fund costs.

We believe that the issue of SMSF costs can best be dealt with by ensuring potential SMSF trustees are receiving high quality and professional financial advice on establishing an SMSF that takes into account their circumstances (i.e. investment approach, administrator, asset holdings, balance, etc.).

We believe that advisers should be able to have a meaningful discussion with potential SMSF trustees on the costs of running an SMSF where the advisers have adequate SMSF knowledge and competencies. Ensuring advisers have undertaken appropriate training and have the right SMSF advice competencies is key to ensuring SMSF recommendations are made appropriately.

Further, cost factors in establishing an SMSF should then be detailed in the client's Statement of Advice (SoA) in a manner that is relevant to the client's individual

[3] SPAA/Russell Investments, Intimate with Self-Managed Superannuation 2014.

circumstances. SPAA would expect that advisers would undertake such disclosures in their SoAs in order to comply with the best interest duty and other *Corporations Act 2001* disclosure requirements.

Should there be any limitations on the establishment of SMSFs?

SPAA does not support introduction of any arbitrary barriers to establishing an SMSF as this would inhibit consumer choice and flexibility within the superannuation system to manage retirement savings in a way that suits different individuals. However, SPAA does acknowledge that there should be a requirement for trustees to have a clear understanding of trustee responsibilities and that SMSFs require more significant involvement and engagement than applies with being a member of an APRA-regulated superannuation fund.

Further, SPAA notes that the positive performance of the SMSF sector has been endorsed by APRA and the ATO, and, that its role in offering consumer choice and flexibility was endorsed by Treasury in its initial submission to the FSI. These factors should be taken into account when considering any policy changes to limiting the establishment of SMSFs.

Minimum SMSF balance

An often discussed barrier to establishment of SMSFs, especially by parties seeking to stem the flow of industry or retail fund members to SMSFs, is to introduce a mandatory minimum balance for SMSFs.

SPAA adamantly opposes the introduction of any minimum mandated balance requirements before a member or members can establish a SMSF for a number of reasons.

SPAA believes that any such restriction would unfairly discriminate against SMSFs, especially when SMSFs are established in order to maximise superannuation savings for retirement and must comply with the *Superannuation Industry (Supervision) Act 1993 (Cth)* (SIS Act) and tax provisions. Preventing or deferring the member's ability to establish a SMSF would be counter to the fundamental principles underpinning superannuation. Also, this type of action is likely to further disengage members of large funds who are seeking alternative options.

SMSF statistics published by the ATO show that the average balance of an SMSF on establishment in 2011-2012 was $185,632. SPAA believes that this average illustrates that the majority of SMSFs are being setup with an appropriate balance.

SPAA believes that setting arbitrary minimums for SMSFs cannot be supported. The reason is that there is no evidence that setting a minimum will mean that funds above or below that mark are administered appropriately or they will be better administered by transferring balances under the arbitrary amount to APRA regulated funds.

The imposition of minimum balances also introduces complications and unanswered questions around the following critical areas:

- How would regulatory controls and policing of minimum balances be achieved?
- Issues will arise with border line cases where a member satisfied the minimum balance at the time of establishing the fund, but due to adverse movements in investment markets, now has less money being transferred into the fund.
- If delays occur in transferring funds from a roll-over institution and the fund receives SGC contributions, does the fund satisfy the minimum balance requirement?
- Why is a minimum balance required when superannuation is compulsory and choice permits it to be paid in to any fund the member instructs?
- Setting minimum balances creates issues if the value of an existing fund falls below the minimum set balance due to members leaving the fund, payment of lump sums and pensions or caused by volatile investment markets, such as those experienced through the GFC.
- Government reduction of contribution caps has limited the ability to establish larger superannuation balances and members should not be disadvantaged or prevented from establishing an SMSF because of an inability to establish higher balances.
- If barriers are to be introduced in establishing an SMSF then would upper thresholds be set for balances in APRA funds to indicate the use of an SMSF may be a more suitable option for the member?

Also, the Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System (the "Cooper Review") considered whether a minimum balance of around $200,000 should be required for SMSF establishment and recommended against introducing any minimum balance. The Cooper Review stated that disclosure and availability of comparable cost data, which now exists, should ensure SMSFs are established appropriately.

As discussed above, SPAA believes the key to ensuring that SMSFs are established appropriately is high quality and professional financial advice which reflects that size and scale are critical to the decision to establishing a SMSF.

Trustee Education

Another often mentioned limitation on establishing an SMSF is to introduce compulsory education requirements for SMSF trustees.

SPAA is opposed to any form of mandatory education for SMSF trustees which is linked to establishment of an SMSF.

SPAA believes that mandatory training would impose an unnecessary barrier to entry, be anti-competitive and discriminatory against the SMSF sector. It would also place members of SMSFs at a disadvantage when compared to members of APRA regulated funds. SPAA acknowledges that SMSF members do have extra trustee responsibilities in relation to their funds.

However, members of APRA-regulated funds are required to make informed choices relating to the fund they wish to contribute to, the investments and insurance options they select, as well as read and understand the PDS, annual report and members' statements. This is especially true where APRA-regulated funds offer "member direct" investment options which allow a member to select direct investment in listed securities and other investments without the need for financial advice or proving their financial literacy and knowledge. Therefore, the imposition of mandatory training for SMSF trustees would be inconsistent with the fact that there are no requirements imposed on members of other superannuation funds, including small APRA funds.

SPAA draws an analogy between SMSFs and privately owned and operated businesses in Australia where, in the vast majority of cases, there is no requirement for training, education or competence requirements prior to establishing a business whether it operates as a company, trust, sole trader or partnership. Further, it should be recognised that unlike trustees of APRA-regulated superannuation funds who are responsible to a broad range of members, SMSFs are small funds (typically two people – in 2011-12 69.2% of SMSFs had two members)[4] where the trustees (or directors of the corporate trustee) are also the members of the SMSF, and only responsible to themselves. Accordingly, it should be left to the trustees own judgement as to whether they need or want to improve their education in regards to managing their SMSF.

SPAA believes that the focus of education should be directed to advisers and other service providers who give professional advice and support to trustees and members. SPAA also believes that all superannuation fund members, including members and trustees of SMSFs, should be encouraged to gain a greater understanding of superannuation and improve their financial literacy, and accordingly, advocates incentives to encourage voluntary education.

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[4] https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Quarterly-reports/Self-managed-super-fund-statistical-report---March-2014/?page=2#Membership_sizes_table

Also, the recent implementation of the SMSF penalty regime requires SMSF trustees that have contravened certain SIS Act provisions to undertake mandatory SMSF training. SPAA believes that this is an appropriate remedy for SMSF trustee education where a lack of knowledge has resulted in contravening superannuation laws. SPAA has applied to provide SMSF Trustee education services as part of the ATO program.

Finally, SPAA notes that the issue of trustee education was considered by the Cooper Review which determined that it did not believe that mandatory SMSF trustee education would achieve little and any decisions to undertake education by trustees should be voluntary.[5]

[5] Super System Review – Final Report, p 225; http://www.supersystemreview.gov.au/content/downloads/final_report/part_two/part_2_chapter_8.pdf

Stability of superannuation policy settings

Observation

Superannuation policy settings lack stability, which adds to costs and reduces long-term confidence and trust in the system.

SPAA agrees with the Panel's observation that a lack of stability in superannuation policy settings damages consumer confidence and trust in Australia's superannuation system. In recent years SPAA has been alarmed at the constant changes to superannuation, especially to the tax incentives for Australians to save via superannuation. This has resulted in many Australians losing confidence in the superannuation system and reducing their contributions to superannuation savings.[6]

We believe that continual change to superannuation regulatory and tax settings, especially changes aimed at meeting short-term fiscal goals severely disrupts retirement planning which reduces the effectiveness of superannuation as Australia's key retirement saving vehicle.

Australia is broadly recognised as one of the best retirement structures in the world. However, successive governments have put the structure at risk by tinkering with superannuation taxes. SPAA does not support policy changes, particularly for the sole purpose of meeting short term fiscal goals, at the expense of encouraging long term savings to help meet Australia's aging, health and population challenges. SPAA views the tax concessions for contributions to superannuation as fundamental to the policy design of the Australian superannuation system which encourages Australians to save a reasonable amount for a sustainable retirement. Having a stable taxation environment for superannuation is essential for retirement planning and maintaining confidence in the system.

These decisions carry further ramifications because of the adverse effect on the confidence of consumers in the superannuation system. We note that a recent Vanguard/Rice Warner survey of SMSF trustees noted that 88% of respondents were concerned that they will be impacted by changes to superannuation or taxation law.[7]

With Australia's aging demographic and a dependence ratio that will reduce from around five workers for every dependent person to around two and a half workers per dependent person over the next 20-25 years, a well-functioning superannuation system is more important than ever. A loss of confidence in super has a direct impact on the level of

[6] SPAA/Russell Investments, Intimate with Self-Managed Superannuation, 2012, 2013, 2014
[7] Vanguard/Rice Warner, Survey of Financial Needs and Concerns, 2014

superannuation contributions and retirement savings in the community and increases eventual reliance on the Age Pension. SPAA research has shown that the decrease in superannuation contribution caps and reduction in trust and confidence of superannuation system saw contributions to superannuation fall by $16.4 billion in 2013, $16.8 billion in 2012, and, $12.4 billion in 2011.[8] Importantly, while 74.6% of these possible contributions were invested elsewhere (with a high proportion in negatively geared property), 25.4% were consumed rather than saved for retirement.[9]

The superannuation sector is heavily regulated and SPAA opposes policies which remove the incentive to save via super and thereby encourage the use of alternative less regulated tax favoured structures as a retirement savings vehicles. SPAA research has shown savings that have not been contributed to superannuation have flown to other tax-preferred investments, especially negatively geared property.[10]

We believe that any changes to superannuation should be taken with a long-term view that maintains the superannuation system's primacy as Australia's retirement savings vehicle. Changes to superannuation should consider the long-term nature of superannuation, retirement outcomes and Australian investment and avoid retrospective implications for current savers. Accordingly, we believe that it is difficult to implement superannuation tax reforms which produce short term revenue gains for the Government and which do not substantially disrupt the current superannuation savings plans of many Australians.

Proposal – set an overarching retirement income goal for superannuation

The three primary superannuation objectives set in the early 1990s with the introduction of the superannuation guarantee and the establishment of the three pillar retirement income system were:

- To provide retirement incomes for all Australians
- To build an investment pool of assets for Australia
- To relieve the pressure on the Australian age pension

We believe that in order to achieve policy stability, an important first step is for the Government to settle on an overarching goal for the superannuation system. Setting an overarching goal for the system will help ensure that any future changes to the superannuation system are made in a way that does not impede the superannuation system from achieving its essential aim.

At its core, we believe the primary goal of the superannuation system should be the provision of income in retirement. Also, setting the overarching goal for the superannuation

[8] SPAA/Russell Investments, Intimate with Self-Managed Superannuation 2012, 2013, 2014
[9] SPAA/Russell Investments, Intimate with Self-Managed Superannuation 2013
[10] SPAA/Russell Investments, Intimate with Self-Managed Superannuation 2012

system should recommit to the three pillar approach to retirement income policy. Further, the goal should include the basic principles of:

- Adequate retirement incomes.
- An equitable system.
- A sustainable system.
- A simple system.

Having an overarching goal with a set of policy principles will guide future governments in policy changes they make to superannuation. It will also give the superannuation industry and consumers a baseline on which it can evaluate policy changes on.

SPAA suggests that the Government develop this overarching goal in consultation with the superannuation industry and members of superannuation funds, including SMSF trustees and members. SPAA recommends that developing an overarching goal include a recommitment to the three pillar system.

Proposal – review superannuation settings as part of the Intergenerational Report process

To promote policy stability SPAA recommends that significant changes to the superannuation system (i.e. changes to contribution caps, changes on taxation of benefits or earnings) only be undertaken as a result of a review of superannuation settings linked to the Intergenerational Report.

The Intergenerational Report is required under the *Charter of Budget Honesty Act 1998* to be completed every five years and released by the Treasurer at the time. As the Intergenerational Report assesses the long term sustainability of current Government policies over the 40 years following the release of the report, with a focus on demographic change, it is a sensible vehicle on which to base superannuation policy changes.

Having the Intergenerational Report released once every five years will allow the Government, industry and consumers to take a "health check" on the superannuation system to see whether it is achieving its goals and whether any adjustments/changes to policy settings are required. The process should allow Government and key stakeholders in the system to evaluate the superannuation systems fulfilment of its goals and whether any structural changes to the system are needed. In-built with this process should be orderly and timely consultation with participants in the superannuation system.

This would allow the superannuation industry and consumers to have confidence that changes to superannuation will only be made with a long-term focus rather than in an arbitrary manner or with short-term Federal Budget goals as a key motivation.

Superannuation costings distort policy debate

SPAA believes that the current Treasury method of measuring the value of the superannuation tax concessions is biased against the superannuation tax concessions and misinforms policy decisions regarding the concessions. The fiscal cost of the superannuation incentives has been a reoccurring policy issue in recent times and any policy decisions should be made with reference to accurate information and costing.

We believe that the current methodology of measuring the concessions as tax expenditures using a comprehensive income benchmark is misleading the public policy debate around superannuation tax concessions. This method results in any derivation from income being taxed at the relevant taxpayer's marginal tax rate via the concessions being a tax expenditure. This does not focus on the future taxation of earnings or benefits and does not account for the superannuation systems purpose of providing retirement incomes.

SPAA acknowledges the current methodology is theoretically correct under a comprehensive income benchmark tax expenditure approach. However, it has a number of weaknesses which skews the superannuation tax concession debate including:

- It does not account for future savings to Government from reduced Age Pension expenditures or tax revenue derived from earnings of superannuation investment or benefits which are taxed on withdrawal.
- It does not take into account that superannuation balances would be lower if there was higher tax on superannuation contributions and earnings, resulting in an inconsistent long-term approach to estimating the tax expenditures.
- It does not account for behavioural changes if superannuation was taxed less concessionally, ignoring that taxpayers would seek out other tax-preferred investments such as negatively geared property. SPAA research has shown that where low contribution caps have restricted SMSF trustees' concessional contributions, 28% said that they would use savings for gearing purposes. However, we do acknowledge Treasury's work in estimating the "revenue gain" figures which factor in limited behavioural changes and their intention to continue to clarify the intended purpose of tax expenditure estimates.
- There is a misconception that removing the tax expenditures associated with superannuation would result in a corresponding increase to revenue and budget position. We acknowledge that Treasury warns against this issue in the TES document.
- It is a short-term year snap shot, which is poorly reflective of the long term policy goals of superannuation.

We believe that these issues distort the debate regarding the level of concessionality and the appropriateness of concessional taxation of superannuation contributions as an incentive for people to save for their retirement.

Further, the short-term budget forecast figures that use four year estimates for changes to the concessions, and similar focus of the Tax Expenditure Statements on single income years are inappropriate for assessing the superannuation concessions. These short-term costings create myopic views of the superannuation tax concession which often support arguments to reduce the concessions.

Proposal – superannuation concessions to be estimated using a tax expenditure benchmark

SPAA recommends that Treasury use an expenditure tax benchmark to estimate the cost of the superannuation tax concessions, or gives greater prominence to an alternative expenditure tax benchmark estimate of superannuation tax expenditure estimates.

Under a pre-paid expenditure tax benchmark, the size of the concession granted to superannuation would be limited to the difference between a taxpayer's marginal tax rate on their labour income (salary and wages) and the concessional rate on superannuation contributions. Superannuation earnings and benefits would be tax free under this benchmark as returns to savings are viewed as tax-exempt. This type of expenditure tax benchmark is reflective of Australia's superannuation system and would be more useful in public policy debates regarding superannuation tax concessions.

Also, an expenditure tax benchmark would be more appropriate for estimating the superannuation tax concessions as it reflects that the value of superannuation takes form when superannuation benefits are received and spent. It also reflects that the majority of taxpayers do not differentiate between current consumption and future consumption. Further, an expenditure tax benchmark is appropriate for superannuation as it compares superannuation savings to a situation where taxpayers save out of their pre-tax income, which mirrors compulsory superannuation contributions and a large part of voluntary superannuation contributions.

An expenditure tax benchmark – either a pre-paid or post-paid benchmark – will result in the tax expenditures of the superannuation tax concessions being far lower than what they are estimated to be under the comprehensive income tax. This was illustrated in the *2013 Tax Expenditure Statements* where Treasury undertook experimental estimates of superannuation tax expenditures using an expenditure tax benchmark. The experimental measurement resulted in a superannuation tax expenditure of $11.2 billion in 2013-14, far less than the often quoted $32 billion figure.

Proposal – superannuation concessions should be assessed as part of the retirement income system rather than the tax system

Besides measuring the fiscal cost of superannuation tax concessions with an alternative tax benchmark, SPAA also suggests that the concessions should not be assessed as part of Australia's tax system as a pure tax expenditure but should be evaluated within the context of Australia's three pillar retirement income system.

This would see the fiscal cost of the superannuation tax concessions evaluated with the costs of providing the Age Pension and superannuation guarantee. This would be a more holistic approach to assessing the cost of the retirement income system, rather than just measuring the tax cost of the concessions. This type of analysis has been undertaken by Mercer[11], which shows that accumulated superannuation benefits reduce future Age Pension payments and associated Government spending.

We believe this approach to assessing the superannuation tax concessions would result in a more robust approach to superannuation tax concessions and foster better policy outcomes for Australian's saving for their retirement.

[11] Mercer, Tax & Superannuation: Securing Retirement Incomes the Shortcomings of the Superannuation Taxation Expenditures, 2013; http://www.mercer.com.au/content/dam/mercer/attachments/asia-pacific/Shortcomings-of-super-tax-expenditures.pdf

Superannuation Tax Concessions

SPAA notes that the Panel has commented in the Interim Report that in regards to superannuation tax concessions

> *"There should be a reasonable expectation that the objectives of the system will be achieved over the longer term. While not conclusive, some evidence raises questions about whether the current policy settings are efficiently targeted and robust."*

and:

> *Furthermore, the majority of superannuation tax concessions accrue to the top 20 per cent of income earners (Chart 4.3). These individuals are likely to have saved sufficiently for their retirement, even in the absence of compulsory superannuation or tax concessions. Some stakeholders question whether this is equitable. It is not clear that superannuation tax concessions for this income cohort will significantly reduce future Age Pension costs.*

SPAA views the superannuation tax concessions as essential to the policy design of the Australian superannuation system which encourages Australians to save a reasonable amount for a sustainable retirement.

Concessionally taxed contributions to superannuation provide an incentive for people to forgo current spending in favour for saving for retirement. It is widely accepted that most people are myopic in their consumption decisions and tend to under save due to inconsistent consumption preferences over time. Accordingly, providing incentives, such as the concessional treatment of contributions and earnings compensates taxpayers for deferring the use of income, promoting income smoothing. Promoting income smoothing by sacrificing current consumption (though contribution to superannuation) will see taxpayer's use their total lifetime income more consistently over their lifetime, especially in retirement.

SPAA agrees that it is important that superannuation tax concessions are achieving their goal of reducing Government expenditure on the Age Pension. At the same time we recognise the need to maintain a sustainable system and also ensure equity in the superannuation and tax systems. However, concessions on superannuation still need to be maintained at a level which allows workers to build adequate retirement savings that will allow them to generate retirement income and manage longevity risk.

In regards to the equity of superannuation, while we acknowledge that there is a vertical equity issue for superannuation tax concessions, we believe that the statement that superannuation concessions are skewed to the top 20 per cent of income earners is over exaggerated. This is because this statement does not factor in that high income earners would seek tax-preferred savings elsewhere if superannuation tax concessions were removed or reduced. For example, these taxpayers would seek to reduce their income tax through geared investments (as shown in SPAA research mentioned above), high yielding shares with fully franked dividends, and family trusts if superannuation concession were less available. The fact that they choose to use superannuation rather than these other tax-effective vehicles to reduce their effective marginal tax rate, skews the use of concessions to high income earners. Further, SPAA believes there is merit that their savings is held in superannuation which has investment regulations and preservation requirements which target savings to being used for retirement income purposes.

SPAA believes that the superannuation tax concessions can be reviewed to address vertical and horizontal equity concerns. However, any policy changes to superannuation tax concessions must ensure that the policy rationales of providing incentives to save for retirement and allowing contribution limits that are generous enough to build adequate retirement savings are kept central to developing options that address equity issues.

Further, as discussed in our retirement income section of this paper, the interaction of superannuation with the taxation and social security systems should be considered with a coherent policy that encourages the sensible drawdown with retirement savings in mind.

The suitability of superannuation tax concessions should be considered as part of the Government's upcoming Taxation White Paper process.

Dividend Imputation

The Panel comments in the interim report that:

> *"The Inquiry notes that, due to refundable imputation credits and tax-free superannuation in retirement, a growing proportion of company tax collected could be refunded to superannuation funds and retirees over time. Although this is of enormous benefit to retirees, it may erode one of the largest sources of revenue for the Australian Government at the same time expenditure pressures are increasing."*

We believe that this is an inaccurate view of the dividend imputation system and its interaction with the taxation of superannuation funds.

Dividend imputation was introduced to remove the double taxation of corporate profits. Under the classical taxation of corporate profits, earnings are taxed once in the hands of the company and again when a dividend received by the shareholder. Dividend imputation removes double taxation by passing on the benefit of tax already paid by the company to the shareholder via a franking credit. Effectively, this makes company tax a withholding tax for corporate profits which are intended to be ultimately taxed at the shareholder's tax rate in all cases.

Asserting that the use of franking credits by superannuation funds which have low or zero (where a fund is totally in pension phase) marginal tax rates undermines the revenue derived from company tax misconceives company tax as being a tax on the company's earnings rather than a withholding tax on corporate profits which are ultimately taxed in the hands of the shareholder. The low or zero tax rate of superannuation funds results in company tax paid on their behalf being refunded to them, as the taxation of superannuation funds dictates that those funds should be paying a concessional marginal tax rate on income which includes corporate profits. Lower or concessional tax rates for super funds is a fundamental part of Australia's super system and is an important incentive for savers to lock away their money in super to save for their retirement.

Superannuation and Leverage

Observation

If allowed to continue, growth in direct leverage by superannuation funds, although embryonic, may create vulnerabilities for the superannuation and financial systems.

While we note that the FSI's concerns relating to direct leverage in all superannuation funds, including equities and property leverage, we will concentrate the major part of our submission on the limited recourse borrowing arrangements (LRBAs) in SMSFs.

SPAA acknowledges certain risks can be created by gearing within superannuation. However, we do not believe that direct gearing through the use of LRBAs is occurring in an excessively risky manner that may create vulnerabilities in the superannuation and financial systems. In fact, as set out below, SPAA believes that lending by way of LRBAs is being done responsibly by the lenders and defaults on those mortgages are lower than traditional consumer lending.

In regards to SMSF use of LRBAs SPAA does not believe there is an excessive use of LRBAs by SMSFs. The most recent ATO statistics show that as of March 2014 SMSFs had a total of $2.781 billion out of total SMSF assets of approximately $558 billion invested via the use of an LRBA.[12] This represents 0.49% of all SMSF assets. This proportionately small level of investment via LRBAs does not pose a systemic risk to the Australian financial system nor to the volatility of the real estate market.

Further, SPAA's discussions with major lenders in the SMSF lending market show that the majority of loans made to SMSFs are being made with responsible lending practices. In effect, banks have tighter lending policies and have experienced lower levels of default than loans made for other purposes.

SPAA has worked with the major lending institutions to obtain SMSF lending data, as at November 2013, representing a sample set of 14,783 LRBAs. This data set was considered by the major lenders to account for approximately 90% of all non-related lending LRBAs in SMSFs. SPAA was able to review the data and was able to ascertain that the average loan to an SMSF is approximately $311,000 with an average loan-value ratio (LVR) between 60% and 75%. The average value of the properties was $450,000. We believe that this indicates that the vast majority of SMSF LRBAs are being made soundly and responsibly.

Further, recent discussions with SPAA members who assist SMSF trustees to borrow from major lenders in relation to LRBAs have noted that lenders are implementing stricter lending criteria in regards to:

[12] ATO, Self-managed super fund statistical report – March 2014

- Requiring SMSFs to have substantial balances before a loan is made (i.e. over $150,000, with some lenders now requiring at least $250,000).
- Assessing loan serviceability on rental income alone (not looking at other SMSF income or contributions to superannuation).
- Restricting lending to established properties (i.e. not lending for investment in off-the-plan developments and special purpose properties such as fast food outlets and petrol stations).
- Not making loans for properties in new residential areas.

Also, the prevalence of SMSFs having only one asset which has been acquired through an LRBA is very low, which adds additional support that LRBAs in general are being used appropriately by SMSFs to ensure there is diversification of assets held by the fund. The ATO statistics indicate clearly that SMSFs investing predominately in a single asset is a very rare situation.[13] It shows portfolios are relatively diverse with real estate investment forming part of the fund's overall asset allocation.

Asset concentration, by type, in 2012

Asset concentration, by type, in 2012 (% of all SMSFs with >50% asset allocation to an asset type)						
Asset type	**100%**	**>=90%**	**>=80%**	**>=70%**	**>=60%**	**>=50%**
Limited recourse borrowing arrangements	0.00%	0.20%	0.30%	0.40%	0.50%	0.50%
Non-residential real property	0.20%	2.50%	4.10%	5.60%	7.10%	8.50%
Residential real property	0.10%	1.10%	1.80%	2.30%	2.90%	3.50%

Source: ATO, SMSF: A statistical overview 2011-12

SPAA believes that any risks created by direct leverage in superannuation funds are only occurring at the extreme fringes of borrowing behaviour.

When used in the right circumstances and structured correctly, there should be little concern that SMSF trustees are using LRBAs inappropriately as part of an investment strategy for their SMSF. However, we are concerned that the recent increase in promotion of LRBAs by certain real estate promoters has an undeserved and unrepresentative impact on the integrity of the SMSF sector. SPAA is aware of increased property spruiking targeting SMSF trustees to become involved in LRBAs as well as increased product development by banks and other financial institutions to target SMSF lending through LRBA products.

While an LRBA used in the right circumstances can assist members to grow their retirement savings, there are also many risks and issues which investor funds should be aware of and considered before embarking on this strategy. Also, SMSF LRBAs which do not comply with

[13] ATO, Self-managed super funds: A statistical overview 2011–12 Table 19: Asset concentration, by type.

the law can cause considerable compliance and financial problems for SMSFs. Some SMSF trustees may not be aware of the serious consequences that may follow. For example, some of these arrangements, if structured incorrectly, cannot simply be restructured or rectified and can result in the SMSF being required to sell the property at a substantial loss to the SMSF or restructure the LRBA at significant cost to the fund.

SPAA believes that the risks inherent in LRBA investment strategies are not always properly explained to SMSF trustees and that in some cases LRBAs are being promoted to trustees where the strategy is not suitable for the circumstances of the SMSF's members. For instance, we are aware of unlicensed and inappropriate advice being provided by promoters recommending people set up a SMSF with an initial $20,000 contribution. An investment property is then acquired through an LRBA without the fund having or acquiring any other investments. This is evidenced by work ASIC has undertaken on inappropriate advice being provided to trustees.

In order to improve the quality of advice provided to SMSF trustees on LRBAs, SPAA has recently published a set of best practice guidelines for SMSF lending and SMSF advice.[14] We believe that by improving the standards of advice and disclosures to SMSF trustees that investment decisions on leverage will be made from a fully informed position.

The LRBA Lenders' Best Practice Guidelines ("Lenders Guidelines") have been developed from established best practice within the banking industry. The Lender's Guidelines establish banking industry standards that can complement individual LRBA credit policy and practices regarding LRBA lending to SMSFs and should encourage and reinforce prudent lending to SMSFs.

The Lenders' Guidelines require lenders to make appropriate disclosures to SMSF trustees that are considering an LRBA. Further, lenders are required to recommend to the SMSF trustee that they seek appropriate specialist SMSF, financial and legal, advice in regards to their SMSF entering into an LRBA. However, at the same time recognising the limited role and responsibilities of lenders in this process.

The LRBA Best Practice Advice Guidelines ("Advice Guidelines") are create a best practice standard of advice that should be provided to SMSF trustees considering the use of LRBAs should they elect to seek personal advice. The Advice Guidelines have been developed from established best practice in advice on LRBAs.

The Advice Guidelines should ensure that when an SMSF trustee seeks appropriate advice regarding the suitability of an LRBA for their particular circumstances, they receive advice from a competent and appropriately licensed adviser who allows them to make the most appropriate decision for their SMSF. Obtaining such advice should help to ensure LRBAs are

[14] http://www.spaa.asn.au/media/240887/spaa_lrba_best_practice_guidelines.pdf

only being used by SMSF trustees after understanding the nature of the investment strategy and the risks associated with it.

Further, as detailed in our section on financial advice, SPAA believes that improving the professionalism of financial advice through a self-regulatory approach will help address concerns around financial advice. SPAA's best practice guidelines for advice on LRBAs are an example of the financial advice industry improving financial advice through self-regulation.

SPAA also notes APRA's concerns and regulatory attention for APRA-regulated funds as to the risks inherent for investments into LRBAs. In this respect it is possible for APRA regulated funds to be less transparent when using leverage in relation to fund investments. This may be done by a range of interposed entities where the fund does not borrow directly but achieves the same outcome as an LRBA.

The Inquiry would value views on the costs, benefits and trade-offs of the following policy option or other alternatives:

- Restore the general prohibition on direct leverage of superannuation funds on a prospective basis.

SPAA believes that restoring the general prohibition on direct leverage of superannuation funds on a prospective basis is unnecessary to mitigate risks of direct leverage as an investment strategy used by superannuation funds.

However, SPAA believes that there are other regulatory measures, in addition to SPAA's self-regulatory push to improve advice on SMSF leverage, which can be undertaken to mitigate risks that leverage within superannuation may create.

Proposed solution – bring LRBA advice under the AFSL regime

SPAA believes that superannuation fund trustees should be protected by the *Corporations Act 2001* financial consumer protection framework when they enter into an LRBA. SPAA considers that proposals to introduce a consumer protection framework should be expedited in consultation with relevant professional groups. Draft regulations produced by the previous government have contained a number of shortcomings and in our view require further development. In SPAA's view, consideration should be given to ensuring that structural advice on LRBAs should be provided by a licensed adviser.

We believe that inclusion of LRBAs in the AFSL regime will help ensure SMSF trustees are being properly advised on both the risks and the benefits of LRBAs and the suitability of the strategy for their fund. The licensing of these arrangements is also entirely consistent with the views expressed by the Super System Review Panel (the Cooper Review) which concluded such consumer protection measures were appropriate in light of the 2007 amendments to the borrowing provisions.

Further, bringing LRBAs into the AFSL regime will ensure that providing advice on LRBAs falls under the Future of Financial Advice (FOFA) provisions. This will mean that the best interest duty obligations and the ban on conflicted remuneration will apply to LRBA advice. Applying the FOFA provisions to LRBAs will outlaw any unprofessional remuneration, such as payments from property scheme promoters to accountants or financial planners, from applying to LRBAs.

Increased ASIC resources

Consistent with requiring that LRBAs be a licensed financial product, ASIC as the regulator of financial advice, needs to be appropriately resourced to police advice provided to SMSF trustees on LRBAs. Even without including LRBAs as a financial product, increased ASIC resourcing would allow the regulator to take more action on advice provided to SMSFs on LRBAs by unlicensed individuals. This type of advice can come from mortgage brokers and real estate agents who recommend that an investment property be acquired through an SMSF.

Limit use of guarantees

Limiting the use of personal guarantees by SMSF members is another possible policy measure which could minimise risk in leverage used by SMSFs creating any systemic vulnerabilities.

Personal guarantees given by members of SMSFs allow the SMSF to undertake larger borrowings with higher loan-to-value ratios. While SPAA is comfortable that the vast majority of SMSF borrowing is being made within sensible LVR limits, prohibiting SMSF members from providing a personal guarantee for their SMSF's borrowings would make it more difficult for lenders to make risky and high LVR borrowings to SMSFs.

Without personal guarantees, an SMSF would need a significant sum of capital to undertake investment via an LRBA in view of stricter lending policies that could be expected. This would limit the ability of property spruikers to use SMSF LRBAs as an investment vehicle for promoting speculative property investments to investors and, in particular, would reduce the ability for property spruikers to encourage individuals to set up a SMSF with a small balance simply to purchase a property within the SMSF.

Tightening related party borrowings

Another possible policy solution to minimise risks associated with superannuation fund leverage is to tighten existing requirements for related party borrowing by SMSFs. Related party borrowings, which are permitted by the SIS Act, allow the SMSF to borrow from related parties via an LRBA. These borrowings, while needing to be on an arm's-length basis in accordance with the SIS Act, can allow for SMSFs to undertake more risky and higher LVR arrangements and also allow for SMSFs to borrow on a zero interest basis.[15]

A possible solution to tighten the use of related party borrowing via an LRBA could be to amend section 109 of the SIS Act which requires investments of superannuation funds are to be made and maintained on an arm's length basis. This amendment may resolve these issues regarding related party borrowing via an LRBA. For instance, we believe a simple amendment to section 109 requiring that the superannuation fund must pay a market or arm's length rate of interest on a related party borrowing could circumvent the problems described above and maintain the integrity of LRBAs.

[15] The Australian Taxation Office stated at the June 2012 meeting of the Superannuation Technical Sub-group of the National Tax Liaison Group that a related party could lend to their SMSF at a zero interest rate without contravening the SIS Act (i.e. the zero-rate does not contravene arm's length investment requirements or count as a contribution to the fund).

Retirement Income

Observation

The retirement phase of superannuation is underdeveloped and does not meet the risk management needs of many retirees.

SPAA considers that that the retirement phase of superannuation is developed to a satisfactory level but can be developed further.

There are certain aspects of the retirement phase in superannuation which can be further developed. SPAA believes this broad observation is not an accurate reflection of the industry and concludes that the retirement income phase of superannuation needs further product development in order to be considered "more developed". The existing retirement income policy flexibly satisfies the demands of a large number of retirees with suitable options, especially account based pensions, for managing retirement income preferences.

It is important, from a conceptual perspective, to separate the need to further develop retirement income advice and retirement income products. Focusing on the need to further develop or mandate the use of retirement income products alone neglects to recognise the strengths of the current retirement income policy settings and the role that quality financial advice should play in best utilising the current system. Similarly, not looking at how current advice practices and consumer financial literacy and understanding of retirement risks affect the retirement phase of superannuation is misguided as it places an overemphasis on the mandating of products to fill this gap.

SPAA is concerned by the Panel's focus on the need to provide a greater array of retirement income products and the need to incentivise or compel the take up of these products. SPAA believes that any focus on retirement income products should result in neutrality and equity between different products so that retirees are able to choose a retirement product that best suits their needs.

A focus on defining what types of products are able to qualify for taxation and social security concessions would be erroneous in SPAA's view. Instead, we believe that any change to the system should focus on providing a universal framework which encourages regular, consistent drawdown on retirement savings for meeting the needs of retirees. Such a system should not prevent retirees from adjusting their income drawdown arrangements to meet changing circumstances as required (i.e. does not lock retirees into, or out of, particular products).

We note that the SMSF sector successfully provides retirement income streams to retirees under the current regulatory settings. The existing retirement income policy settings have allowed for a broad range of retirees with varying circumstances and lifestyles to effectively manage retirement incomes through account based pensions via an SMSF. Account based pensions have allowed SMSF trustees to drawdown on their retirement savings over time in a manner that suits them and allows flexibility to withdraw capital to meet lump sum costs as demands dictate, for example, unexpected medical and aged care expenditure.

SPAA believes the existing account based pension system not only provides the flexibility for managing the drawdown of retirement savings to provide income streams but believes that it can be used to manage longevity risk. SMSF trustees are able to manage longevity risk through an account based pension approach by managing separate pension accounts targeted at short and long-term income needs. These separate pension accounts can have different investment approaches, with the "longevity account" part of the fund focusing on long-term investments for income later in life. Even though under current drawdown rules, a minimum must be drawn down form the longevity account, this can be replenished by partially commuting part of the other pension account and restarting the longevity pension with the commuted capital added in.

A well-functioning approach to managing retirement income and associated risks as indicated above can be enhanced by developing a greater range of underlying investment options which trustees can use to manage retirement income and longevity risks. For example, the provision of longer term Government bonds, inflation-linked bonds or similar investments for both product providers and superannuation fund trustees alike would assist retirees in managing retirement income and longevity risk.

Furthermore, the account based income stream system is underwritten by the Age Pension as a form of longevity insurance for retirees that outlive their retirement savings. SPAA recognises and supports the importance of maintaining a sustainable Age Pension in regards to providing or supplementing retirement income and believes it is integral to the management of longevity risk. Ultimately, the Age Pension is an important and robust means tested default for managing longevity risk.

ATO statistics indicate that in the 2011-12 income year there were 35.1% of SMSFs in pension phase.[16] Furthermore, it estimated that SMSFs currently hold $294 billion of Australia's retirement income funds under management (65% of total Australian retirement income funds under management).[17]

SPAA research has found that 66.7% of SMSF trustees are confident that they can meet their retirement objectives.[18] This is in contrast to non-SMSF trustees, who have far less confidence in their retirement outcomes with 47.3% saying they expect to fall short of their

[16] ATO, Self managed Superannuation Funds: A Statistical Overview 2011-12
[17] DEXX&R, Media Release, December 2013 http://www.dexxr.com.au/news/2013Dec_Market%20Projections%20Media%20Release_vWeb.pdf
[18] SPAA/Russell Investments, Intimate with Self Managed Superannuation 2014

retirement target whereas only 25.4% of SMSF trustees believe they might not meet their retirement objectives.[19]

Some factors that allow SMSFs to successfully deliver retirement income streams are:

- SMSF trustees/members setup their SMSF with the intention of using it to manage retirement income rather than just as a superannuation accumulation vehicle.
- SMSF trustees/members are more engaged with their superannuation meaning that they have a natural focus on retirement income outcomes.
- Account based pensions have allowed SMSF trustee/members flexibility to manage and drawdown on their retirement savings in a manner that suits their individual circumstances.
- Account based pensions have allowed SMSF trustee/members to optimize returns through an appropriate balance of underlying investments (inevitably some of these investments carry with them risk, but an optimal return result cannot be obtained without this.)
- SMSF trustees/members are conservative in their investment strategies, with 28% of SMSF assets held in cash or fixed interest products.

It is important to note that other countries that have had compulsory arrangements for retirement incomes, such as the United Kingdom, have recently moved away from retirement income policies which mandate the use of certain retirement income products. These systems now allow more flexible drawdown arrangements which give greater flexibility and control to meet retirees' needs. The problematic experience with retirement income products in these jurisdictions should temper the view of the Australian retirement income sector as being underdeveloped.

Also, we note that the Australian retirement income system ranks in the top echelon of pension systems globally. The 2013 Melbourne Mercer Global Pension Index ranks Australia in the top three pension systems on a global basis.[20]

SPAA believes that the current retirement income system offers appropriate mechanisms to manage retirement income streams and longevity risk. SPAA also believes that there can be improvement in the quality of advice provided to prospective retirees on retirement income. SPAA research has identified a gap between the recognition by prospective retirees of the need to change investment strategies and put in place arrangements to provide

[19] SPAA/Russell Investments, Intimate with Self Managed Superannuation 2014
[20]Mercer/ACFS, Melbourne Mercer Global Pension Index, 2013; http://globalpensionindex.com/2013/melbourne-mercer-global-pension-index-2013-report.pdf.

retirement income and where action is actually taken.[21] This gap can be "filled in" through the increased provision of financial advice to focus on retirement income results.

SPAA believes that the gap referred to in the previous paragraph is already being filled quickly with advisors being more aware of longevity risks, sequencing risks and the need to shift investment strategies in the lead up to retirement.

The current regulatory settings, which underlie the account based pension approach to providing retirement income streams for superannuation provide the most flexible settings for paying superannuation income streams.

Account based income streams permit a degree of flexibility by requiring a minimum amount to be drawn from the member's pension account balance each year with no cap on the maximum amount that can be withdrawn. The mandatory minimum amount is calculated on the basis of the member's age falling within an age range and the account balance at the time the income stream commences or at the commencement of the financial year.

Account based income streams have their origin in the rules for allocated pensions that commenced in the mid-1980s which permitted drawdowns on the basis of published minimum and maximum factors. The main advantage of account based income streams is the opportunity for the pensioner to draw down amounts above the minimum to provide for living expenses as they fluctuate during retirement. The minimum amount appears to be determined broadly by reference to the life expectancy of a person. If a person draws down the minimum amount only during their life time it could be expected that the balance of the pension account would increase based on various earnings rate assumptions until the person's life expectancy of the low to mid 80s. Once a person reaches age 85 the rate of drawdown of the account based income stream increases.

It is SPAA's view that in view of increases longevity and the potential changes in spending patterns due to changes to health and aged care that the manner in which the minimum is set should be adjusted to take these changes into account.

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

A spectrum of options to achieve the objectives of the retirement income system and position Australia to manage the challenges of having an ageing population:

- Maintain the status quo with improved provision of financial advice and removal of impediments to product development.

[21] SPAA/Russell Investments, Intimate with Self Managed Superannuation 2014.

- Provide policy incentives to encourage retirees to purchase retirement income products that help manage longevity and other risks.
- Introduce a default option for how individuals take their retirement benefits.
- Mandate the use of particular retirement income products (in full or in part, or for later stages of retirement).

Generally, SPAA believes that in order for the Australian retirement income system to manage the challenges of having an aging population, there needs to be greater coordination between the retirement income, social security and tax systems. Australia needs a coherent policy to manage the challenge of an aging demographic rather than a "silver bullet" that pushes retirees into retirement income products aimed principally at managing longevity risk. Policy options to encourage better management of retirement savings that address retirement income and longevity challenges must be considered holistically.

A coordinated policy approach across the retirement income, social security and tax systems would create a principles based system to encourage the steady drawdown of retirement savings. This would provide retirement income and at the same time manage longevity risk. The design of retirement income regulations such as the minimum and maximum drawdowns provided in the SIS Act and *Superannuation Industry (Supervision) Regulations 1994 (Cth)* (SIS Regulations), social security income support means testing (i.e. Age Pension means testing) and tax settings (i.e. taxation of retirement benefits) would need to be amended to manage this risk and drawdowns.

Maintain the status quo with improved provision of financial advice and removal of impediments to product development.

Financial advice

SPAA believes that improving the quality and provision of financial advice regarding retirement income outcomes would strengthen the existing retirement income settings.

Improved financial advice and financial literacy in this area would allow retirees to better utilise the existing account based pension system to manage their retirement income and longevity risks.

Improved financial advice on retirement outcomes and strategies can be implemented through raising training standards for financial advisors that provide advice on superannuation and including specific competencies on retirement outcomes in their required training.

As foreshadowed above, SPAA believes that the gap in advice on retirement outcome is quickly being met by the financial advice market. SPAA conferences and education events continue to place greater emphasis on sessions that educate delegates on retirement income and longevity issues. Further, SPAA members have indicated that they are increasingly aware of the need to provide advice on income streams, longevity risks and sequencing risks, as well as retirement savings adequacy.

Furthermore, in our financial advice section of this submission, SPAA has proposed a greater self-regulatory approach to improve the standards of professionalism and competency in financial advice which would be important in addressing the quality of financial advice provided on retirement income issues.

Impediments to product development

SPAA supports the removal of regulatory impediments to the development of retirement income products. However, it strongly believes that any change to current legislation needs to ensure neutrality across retirement income products, for example, account based products and annuity style products.

There have been certain impediments identified, particularly in the SIS regulations which should be removed. There should also be greater co-ordination between regulators in the product approval process. SPAA would be concerned if the outcome distorted the neutrality and equity between retirement income products. Decisions by consumers should be made on managing retirement income and longevity by choosing a product that best suits their needs rather than one which provides favourable tax or social security outcomes.

Any changes to regulations to allow the development of annuity or deferred lifetime annuity (DLA) products should ensure that similar approaches to managing longevity risk can be maintained in the account based pension/SMSF environment. For instance, if DLAs are to benefit from a tax exemption on investment earnings through the deferral period, then SMSF trustees should be able to setup deferred market linked income streams within the fund and receive equivalent tax treatment for their assets that are put aside in the fund during the deferral period. A deferred market linked income stream has the same purpose and intent as a DLA – that is, to defer the consumption of capital to a later time and manage longevity risk. Therefore they should receive the same regulatory treatment as other products that receive the same retirement income outcome.

Ensuring this type of neutrality occurs across different retirement income products is essential to promoting competition, innovation and reducing distortions in consumer decision making.

Provide policy incentives to encourage retirees to purchase retirement income products that help manage longevity and other risks.

SPAA does not support policy incentives that encourage retirees to purchase a particular type of retirement income product which have the sole purpose to manage longevity and other risks.

SPAA supports coherent retirement income, social security and tax policy settings which provide incentives to "nudge" retirees into drawing down on their retirement savings in a way that accords with the goals of the retirement income system.

A coherent policy encourages the gradual drawdown of retirement savings from retirement onwards by making sure that the social security system and tax system do not allow retirees to benefit from social security and tax preferences where their actions do not align with the goals of the retirement income system.

Policy options that could align with this type of coherent policy principle framework could take the form of:

- Reintroduction of maximum annual drawdown levels in addition to minimum drawdown levels.
- A more comprehensive approach of introducing maximum drawdown ceilings beyond which there are tax or social security disincentives if withdrawals above those maximums are made. Large lump sums would be caught and discouraged by such a policy.
- Re-design of minimum drawdown requirements which are currently being explored in the Federal Government's retirement income stream discussion paper.
- Clawback of some tax-preferences on death of unused capital amounts which could be used to encourage drawdowns and discourage superannuation being used as part of estate planning strategies.
- Politically tolerable grandfathering introduced in stages.

We believe that a product-neutral approach that encourages retirement income streams will result in the optimal outcomes for retirees. Products that meet set drawdown parameters with the aim of achieving the retirement income system's goals for managing longevity risk ensures retirees drawdown on their retirement savings appropriately. If necessary they may qualify for relevant social security and tax concessions.

If incentives were granted for specific types of retirement income products, SPAA strongly believes that tax or social security concessions should not favour a category of products over other retirement income streams. Examples would include, granting a tax exemption during deferral stage for deferred annuities or providing means testing exemptions for lifetime annuities. Maintaining a level playing field between retirement income products ensures the integrity of the retirement income sector and fosters competition between product providers to drive efficiency and innovation.

In addition to maintaining product neutrality in the retirement income sector, SPAA believes that any move in giving annuity based retirement income products tax or social security advantages needs to consider the risks inherent of the products.

One of SPAA's key concerns about incentivising investment in annuity type products is that retirees will often have a lower income in retirement when using an annuity product.

Annuity products result in the product provider accepting the investment risk for the product in exchange for a premium for accepting the risk and providing a guaranteed income stream. Retirees lose out on increases in their income when investment returns on assets supporting the annuity exceed the guaranteed income entitlement. Over the longer-term, we believe this will result in lower retirement income for retirees who manage retirement income through these products.

Lower retirement incomes for retirees will flow through to affecting government expenditure on supporting retirement incomes through the Age Pension. Shifting retirees to lower incomes associated with annuity products may counterintuitively increase the need for Government assistance later in life rather than reduce it. Therefore it is necessary to allow development of a range of retirement income products which address the issue of changes in longevity.

Further, locking in future annuity payments based on current interest rates can lead to sub-optimal results for retirees. This will depend on when and how they are locked into the annuity purchased. For example, a retiree purchasing an annuity in the current low-interest rate environment may end up being locked into historically low returns for longer than necessary.

A risk associated with an annuity type product is that it can dislocate the allocation of superannuation capital as retirees are not motivated to seek returns which can fund their retirement income needs. Instead capital is allocated on a basis that covers the risk of an annuity product provider's obligations to retirees that have purchased one of their products. This may result in suboptimal allocation of capital, stymying the most efficient use of the superannuation capital pool.

Another significant concern in passing investment risk from a retiree to a product provider is the exposure of the trustee to counter-party risk. This is especially relevant over longer time horizons which would be involved in annuity of deferred annuity products. DLAs have a high degree of tail-risk created by the variability in life expectancies (especially, later in life).

Any failure of product providers to meet their obligations to trustees over the term of their product would surely result in questions as to whether Governments will either guarantee products or bail product providers out. This was evident during the global financial crisis where, in some cases, guarantees were not supported. The political reality of this situation creates an implicit guarantee for annuity type retirement products. These results give rise to moral hazard and increase risks in the financial system.

It would be appropriate policy that a DLA should only qualify for concessional treatment where it is parallel to an existing retirement income stream. Without such an arrangement, policy settings may encourage retirees to defer the use of capital to later in life and rely on government support earlier in their retirement. This would allow them to consume capital through lump sum withdrawals rather than as receipt of an income stream. The reliance of the retiree would merely shift to government support in relation to managing longevity (i.e.

from latter in life to earlier) rather than decreasing the overall reliance on government support.

Neutrality between DLAs or other annuity products and account based pensions should be maintained by ensuring equal treatment for any capital that is remaining at the time of a retiree's death.

Similarly, the ability to commute DLAs may need to be restricted to prevent retirees from taking advantage of a tax deferral period and then draw down the product as a lump sum. Alternatively, it may be appropriate to claw back tax exemptions and other concessions that are made available to the DLA during the deferral period where it is commuted before death of the retiree.

Also, if DLAs are to be granted tax or social security concessions to act as an incentive for their take-up, equivalent concessions should be extended to long term (i.e. age 100 -105) market-linked deferred income streams so that a more appropriate range of options is encouraged and made available.

Finally, to maintain neutrality amongst products and to ensure appropriate advice practices are applied to annuities, SPAA would recommend that the existing FOFA carve-out for long-term annuities be removed. Section 963B of the *Corporations Act 2001* carves out certain life risk insurance products from the ban on conflicted remuneration. It would be inappropriate if these products were sold to retirees when advisors were receiving commission for recommending them. Further, if annuity-type products are to be granted tax and social security concessions it is imperative that a level playing field be maintained on advisor remuneration attached to these products to maintain a level playing field between all retirement income products.

Introduce a default option for how individuals take their retirement benefits.

SPAA does not support the introduction of default option for how retirees receive their retirement benefits.

A key concern with introducing an annuity or pension product default is that this proposal may inadvertently place disengaged and unengaged members into an annuity or pension product upon transition from accumulation to the retirement phase without them being aware of the risks associated with the products. Current commentary and research from APRA and other industry sources suggests significantly more than half of members of APRA regulated funds are considered unengaged. We strongly believe that the decision to use an annuity product or begin a pension product should be an active choice of a member. This will require them to obtain specific, personal advice to assist them in making a choice, especially where those members have been or become disengaged or unengaged with their superannuation.

Annuity products are complex in nature and their risks and features are not well understood by the public, especially by less engaged superannuation members. We would be concerned that members may be placed into an annuity or similar product without understanding the nature of the product. This would lock retirees into products that they may not understand and will not provide them with the flexibility to meet unexpected or escalating costs in retirement.

Pension products, especially account based pensions, are generally better understood as they are a more intuitive product for most retirees than an annuity. The features of an account based pension is that the pensioner has a pool of capital to invest, which is drawn down as an income stream based on investment returns and capital to pay a pension. In an annuity, as a comparison, a capital product is purchased which pays an income stream after age X for Y years with specific limitations on what can happen to the original capital sum.

Any proposal to promote or introduce default retirement income products must be accompanied by increased transparency and education as to how annuities, including DLAs, function and what their risks are compared to pensions which currently have rigorous disclosure requirements.

Better education of advisors and consumers, increased information and personal advice will therefore need to play a pivotal role in the introduction of any default system.

Educating superannuation fund members on choice, the long term nature of super, the risk and return profile of investments and retirement products and options is fundamental to improving member participation and engagement with their retirement phase. Members should be educated to improve their level of understanding of their retirement savings and how to best utilise them in retirement. SPAA believes that as members become more sophisticated they will seek more information and choice in retirement products and increased competition will ensure that the market delivers this in an efficient and cost effective manner.

Members in pension phase are typically more engaged with their superannuation than accumulation members. Pension members watch their investment returns very closely given that they only have a relatively fixed amount of money to last for retirement. We suspect a low cost pension product with limited investment options is not going to be of interest for most members that elect to take a superannuation income stream.

We believe that increased education to increase member engagement with their retirement phase options would be the most appropriate solution. It would encourage members to select the retirement product(s) which is most appropriate to their circumstances rather than placing superannuation fund members in a default retirement income product.

In the absence of a default option for retirement income, SPAA would propose that a prospective retiree's retirement savings remain in the accumulation phase of superannuation until they make a choice as to how to utilise their savings. At this point we believe coherent principles-based policy settings that encourage the use of retirement income streams should guide retirees to using their retirement savings appropriately.

Mandate the use of particular retirement income products (in full or in part, or for later stages of retirement).

SPAA is opposed to mandating retirement income products in full, part or for certain stages of retirement.

SPAA maintains that consumers should have choice in how they manage their retirement income and have flexibility in doing so. Locking retirees into mandated retirement income products reduces engagement with their retirement income and reduces the need to be informed and educated about financial decision making in retirement. Further disengagement would be detrimental to the Australian retirement income system.

We believe that educating retirees on the need to manage retirement income and longevity risks should be the appropriate course of action before mandating the use of any products.

Also, we believe that mandating the use of products would discourage innovation and competition amongst institutions providing retirement income products. This would result in more expensive products and lower retirement incomes for retirees.

In this vein, SPAA is concerned by the policy option to mandate annuity products which have high fees and costs when the Panel's interim report has been critical of high fees in Australia's superannuation system. We view a push towards high fee annuity styled products to contradict the Panel's concerns around high costs in the accumulation phase of superannuation. Fees and product costs should be of paramount concern in the retirement phase as retirees are unable to contribute further capital to their retirement savings to make up for the erosion of their retirement savings by fees.

Observation

There are regulatory and other policy impediments to developing income products with risk management features that could benefit retirees.

SPAA is aware that there are impediments in the existing SIS Regulations creating retirement income products. This applies especially to the requirement that an annuity must pay at least an annual payment to the beneficiary.

We are also aware that tax treatment of earnings for DLAs is an issue for product providers and is currently being addressed through the Federal Government's Review of Retirement Income Stream Regulation.

Any amendments to existing regulatory arrangements should maintain neutrality between existing account based pension products and annuity or DLA products.

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Take a more flexible, principles-based approach to determining the eligibility of retirement income products for tax concessions and their treatment by the Age Pension means-tests.
- For product providers, streamline administrative arrangements for assessing the eligibility for tax concessions and Age Pension means-tests treatment of retirement income products.
- Issue longer-dated Government bonds, including inflation-linked bonds, to support the development of retirement income products.

As described above, SPAA believes that a more principles-based approach to retirement income products is the best policy solution to encourage retirees to use their retirement savings in a way that achieves the goals of the retirement income system. Any principles based approach should maintain neutrality between products and maintain flexibility of the current account based pension system to allow retirees to respond to the changing needs of retirement.

SPAA supports streamlined arrangement and greater coordination between regulators and Australian Government departments for assessing the eligibility for tax concessions and Age Pension means-test treatment of retirement income products.

Issue longer-dated Government bonds, including inflation-linked bonds, to support the development of retirement income products.

SPAA strongly supports the Government issuing longer dated and inflation linked bonds to support retirement income products but stresses that any expansion of the Government's debt issuances should also be available to retail investors. Allowing retail investors to access these products encourages those retirees using account based pensions, such as SMSF trustees, to self-manage longevity risk and retirement income.

SMSF trustees seek flexibility and control in the investment of their retirement savings, with most trustees preferring direct investment. The SPAA/Russell Investments 2013 Intimate with SMSFs Report showed that 77.8% of SMSF trustees prefer direct investment over managed funds.[22] Also, the Report showed that 10% of trustees with assets in cash and

[22] SPAA/Russell Investments, Intimate with SMSFs 2013.

term deposits were looking to invest in higher quality low risk products.[23] We believe that these characteristics will mean that SMSF trustees will wish to be able to invest in longer dated government bonds and inflation linked bonds to support account based pensions.

The take up of investing in longer dated and inflation linked bonds by SMSFs accompanied by quality strategic advice will only bolster the already well-functioning SMSF approach to managing retirement income. In addition to government bonds, further access to innovative products – for example, unitised infrastructure investment, corporate debt and shared appreciation housing products – can allow retirees to further self-manage longevity risk and the provision of income streams in retirement.

The Inquiry seeks further information on the following areas:

- Would deferred lifetime annuities or group self-annuitisation be useful products for Australian retirees? Are there examples of other potentially suitable products?
- If part of retirees' superannuation benefits were to default into an income stream product, which product(s) would be appropriate?
- Will the private sector be able to manage longevity risk if there is a large increase in the use of longevity-protected products? How could this be achieved?
- Should Government increase its provision of longevity insurance? How would institutional arrangements be established to ensure they were stable and not subject to political interference?
- What are some appropriate ways to assess and compare retirement income products? Is 'income efficiency' a useful measure?

Would deferred lifetime annuities or group self-annuitisation be useful products for Australian retirees? Are there examples of other potentially suitable products?

While retirement income products such as annuities and DLAs serve a purpose in certain contexts for some retirees, creating a bias towards such products would produce a sub-optimal result for Australian retirees as a whole, for the reasons outlined above. SPAA recognises that the use of these products may be suitable in certain situations but maintains that the retirement income system should encourage flexibility and choice for retirees and not mandate the use of particular products.

[23] SPAA/Russell Investments, Intimate with SMSFs 2013.

If part of retirees' superannuation benefits were to default into an income stream product, which product(s) would be appropriate?

As highlighted above, we do not support defaulting any part of superannuation balances into retirement income products. Retirees should be educated about the need to manage retirement income and longevity risk and make an informed, considered and advised choice as to what retirement income products may be suitable for them.

Will the private sector be able to manage longevity risk if there is a large increase in the use of longevity-protected products? How could this be achieved?

SPAA has concerns in regards to the ability of the private sector to manage longevity risk, especially over the long time frames that counter-party risk exists between a potential retiree and a provider of an annuity or DLA product. Intense and consistent prudential regulation of product providers would need to be maintained to give investors' confidence in engaging in non-transferable counter-party risk over such a long time frame.

Further, robust capital requirements are needed to protect consumers (and governments who would need to bail out failed product providers) from counter-party risk, which reduces the level of investment return that retirees receive from their investment in annuity or DLA products.

Should Government increase its provision of longevity insurance? How would institutional arrangements be established to ensure they were stable and not subject to political interference?

SPAA believes that there is no need for the Government to provide any further form of longevity insurance as the Age Pension already functions as form of longevity insurance. Further, the Age Pension is means tested, meaning that it should only be provided to retirees that genuinely need to access it as a form of longevity insurance. Means testing thresholds at appropriate levels encourages the self-provision of funds of retirement incomes via superannuation.

There is criticism that the existence of the Age Pension undermines retirees' appetites to purchase longevity risk products. SPAA believes applying coherent policy settings (as discussed above) that encourage the sensible and appropriate drawdown of retirement savings over time should alleviate this issue. Further, if the Age Pension is still overused by retirees that have adequate retirement savings to fund retirement income and manage longevity, tighter means testing can be implemented to stop this from occurring. For instance, suitably tailored age based means-testing could support the use of the Age pension as a form of Government provided longevity insurance (i.e. more assistance at older ages, less assistance and therefore more reliance on superannuation at younger ages).

What are some appropriate ways to assess and compare retirement income products? Is 'income efficiency' a useful measure?

Retirement income products are difficult to compare due to the different features they offer to retirees. Retirement income products should not be judged on a simple measure such as "income efficiency" as this will not account for features such as flexibility of account based income streams. We suggest that retirement income products be evaluated by determining how well they meet a retiree's needs, rather than applying a standard metric.

Further, the use of income efficiency as a measure to assess retirement income products will likely make account based income streams appear "inefficient" where there is a death benefit paid on death of the retiree. Such "inefficiencies" can be neutralised with coherent tax and social security settings that discourage non-drawing of income as discussed above. In fact, given the typical outperformance of well-invested account-based pensions, appropriate settings would ensure that these were more efficient than typical annuity alternatives. The concept of income efficiency potentially misrepresents the relative potential ability of different income streams to generate returns and therefore income.

Financial Advice

Observation

Affordable, quality financial advice can bring significant benefits for consumers. Improving standards of adviser competence and removing the impact of conflicted remuneration can improve the quality of advice. Comprehensive financial advice can be costly, and there is consumer demand for lower-cost scaled advice.

Quality Financial Advice

SPAA supports the Panel's observation that high quality financial advice brings significant benefits for consumers. Research undertaken by SPAA in 2012 and 2013 shows that personal advice tailored to a consumer's personal circumstances results in the consumer having increased engagement with their financial future and retirement savings.[24] This aligns with increased consumer satisfaction, knowledge and confidence. Additionally, our research has shown that consumers are increasingly demanding specialised financial advice to assist them in achieving their financial goals.

SPAA agrees that the quality of financial advice needs to be improved in order to meet consumer's needs, especially in the retirement income sector, where consumers are faced with complex information and choices.

In order to ensure consumers are able to access high quality financial advice SPAA agrees that there is a need to increase the standards of training for financial advisers and encourage specialisation in the provision of SMSF advice. The existing ASIC training requirements (*Regulatory Guide (RG) 146: Licensing: Training of financial product advisers)* to provide retail financial advice are not sufficient in SPAA's opinion and need to be raised to ensure consumers are receiving quality advice. SPAA supported ASIC's goal to increase the standards of training for financial product advisers in ASIC Consultation Papers 212 and 215 issued in 2013 but believe that the approaches to financial adviser training and the approval and regulation of courses for RG 146 outlined in the papers were flawed and would not improve financial advice quality.

Conflicted Remuneration

As set out in our submission in response to the Future of Financial Advice Amendments, SPAA has been a strong supporter of eliminating conflicted remuneration. We strongly believe that there is no room for conflicted remuneration in financial services. Accordingly,

[24] SPAA/Russell Investments, Intimate with Self Managed Superannuation 2012; 2013.

we have some concerns regarding the Government's limited exemption for conflicted remuneration for certain types of general advice.

SPAA believes that it is necessary to monitor the effect of the changes introduced by the Government in relation to conflicted remuneration to ensure that they are working as intended. SPAA is adamant that if financial planning is to become a true profession and be a supplier of quality financial advice to consumers, the industry needs to adopt professional characteristics that require a separation of product sales from adviser remuneration arrangements.

Improving the Quality of Financial Advice

SPAA believes that in order to improve the standard and quality of advice being provided, it is necessary that the following areas be reviewed and improved:

1. training
2. competencies, and
3. Professionalism.

A review of the above areas will see better educated advisers who will be better equipped with the requisite knowledge and understanding to provide tailored advice specific to their client's situation.

To support an improvement in the quality of financial advice, SPAA believes that the industry needs to move to a co-regulatory approach for training and determining competencies instead of an environment where a regulator, currently ASIC, sets a regulated mandated minimum (as is currently the approach). The major drawback with the current approach is that there is little incentive or need for financial advisers and their licensees to achieve higher competencies than the minimum requirements set by ASIC. This can lead to lacklustre advice being provided to clients as a result of poor or inadequate knowledge and/or understanding, particularly when it comes to more complex issues. Consumers also expect that advisors who acknowledge that they specialise in a class of product, under the current AFSL regime, are capable of providing advice at an appropriate professional standard and in their best interest.

However, SPAA notes the recent moves by major financial institutions to improve adviser competencies as a response to criticism of advice practices by the Senate Inquiry into the performance of the Australian Securities and Investments Commission.

SPAA believes that a model where professional associations approved by a regulator (i.e. ASIC) are responsible for determining the competency, training and education requirements for financial advice professionals would best serve consumers and the industry. Such a model would promote professionalism and ethics, accountability of advice, raise professional standards, be contemporary with industry developments and increase competencies within the financial services sector. This contrasts with an industry and a system that merely meets a "bottom-line" standard set by the regulator, such as the current RG 146 approach for financial advisers which has been highly criticised.

Co-regulation can be defined as:

> *a regulatory process whereby an industry-level organization (such as a trade association or a professional society), as opposed to a governmental or firm-level, organization sets and enforces rules and standards relating to the conduct of firms in the industry.*[25]

A system of co-regulation would involve one where certain industry associations would be responsible for:

a. setting the relevant education standards
b. approving and providing accreditation for relevant training which meets the education standards
c. determining best practice guidelines for industry participants
d. policing behaviour and the quality of advice provided
e. imposing and being responsible for disciplinary measures where required
f. suspending and expelling members where appropriate
g. protecting consumer interests
h. ensuring that the industry/sector as a whole remains a viable and sustainable one.

Businesses use co-regulation to decrease risks to consumers, increase public trust, and combat negative public perceptions. Not only will consumers benefit from co-regulation, but also the industry participants (the businesses, employers and employees), the government and the economy. To consumers, co-regulation ensures that overregulation does not occur by a government body enshrined with the role of overseeing a particular industry with a relatively fixed set of standards. For businesses, co-regulation can reduce costs that may be incurred as a result of unnecessary or inefficient regulations. These cost savings can be passed on to consumers.

The processes around creating industry rules, monitoring, enforcing and reviewing them can be much faster, simpler and cost-effective in a co-regulated environment. For example, certain rules can be quickly implemented if an emerging trend is identified in the sector.

In relation to financial advice, SPAA believes that a system of co-regulation together with more rigorous ongoing educational requirements (discussed later in this submission) will provide a more robust and dynamic industry. This will see higher quality financial advice

[25] Anil K. Gupta and Lawrence J. Lad, "Industry Self-Regulation: An Economic, Organizational, and Political Analysis," The Academy of Management Review 8, no. 3 (1983): 417.

being provided to consumers without the risk of unnecessary red tape and expensive regulation and compliance.

In addition, if financial advice is seen as a profession, this will lead to an increase in trust and confidence by consumers in their advisers. In turn, this professional relationship between consumer and adviser will lead to a long-term relationship over time where the consumer will use the adviser as and when required, as opposed to seeking an ad-hoc service. This system of rapport building is evidenced in any other professional relationships; take for example the relationship between a patient and their general practitioner.

This long-term relationship allows for an environment where the adviser can provide a more holistic approach to the needs and requirements of the consumer over time as the adviser has the opportunity to better understand the changing needs of the particular consumer. Further, this model promotes fee-for-service arrangements which promotes financial advisers seeking remuneration for value added services instead of commission or sales based remuneration.

Also, we believe that instituting a profession for financial advisers will also encourage advisers to take greater responsibility for the impact that good financial advice can have on the welfare of Australian consumers. For example, under a professional model, pro-bono and lower fee services can be offered as a social good to those who may not necessarily be able to afford those services. This is akin to lawyers who are encouraged by the Law Society which governs them to provide pro-bono services as part of their wider professional responsibility.

SPAA also agrees with the observation that comprehensive financial advice can be costly and there is consumer demand for lower-cost scaled advice. Care needs to be taken by advisers who provide scaled advice. If a consumer has requested specific, limited advice, they should be entitled to receive that advice without having to bear the cost of a full financial plan. SPAA believes that proper disclosures will need to be made clear to clients that the scaled advice is in fact that, to avoid issues where clients may think they are receiving full-scaled advice when they are not.

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Raise minimum education and competency standards for personal advice (including particular standards for more complex products or structures, such as SMSFs) and introduce a national examination for financial advisers providing personal advice.
- Introduce an enhanced public register of financial advisers (including employee advisers) which includes a record of each adviser's credentials and current status in the industry, managed either by Government or industry.
- Enhance ASIC's power to include banning individuals from managing a financial services business.

No change to current arrangements

SPAA supports necessary changes to current arrangements for financial advice. This is due to a number of reasons including:

a) the current training and competency standards are too low and do not promote an environment of technically proficient and experienced advisers;

b) the current settings presume a base competency of "one size fits all" for the provision of financial advice to meet the expectations of consumers who rely on that advice;

c) this current settings do not encourage specialisation by advisers (particularly of difference professions and occupations) of which there is a shortage;

d) with the size of superannuation funds under management increasing it is extremely important that consumers receive quality advice from professional advisers who have undertaken necessary and appropriate education;

e) financial advisers play a very important role in achieving retirement outcomes for individuals (and consequently the Government). It is imperative that advisers are highly skilled and continually kept abreast of legislative and regulatory changes which impact the advice they provide.

SPAA believes that maintaining the status quo when regulating financial planning, especially in regards to education and training, has not worked. The current approach of setting a minimum standard of required training and competencies for financial advisers through

ASIC's RG 146 has not been successful to ensure high quality financial advice is provided to consumers.

RG 146 is not a flawed concept in itself as it simply outlines the minimum requirements expected by ASIC as a guide to advisers, licensees and education providers. However, too often the industry (licensees and educators) have interpreted the minimum requirements to be all that is required to be regarded as competent. For instance, parts of the industry have interpreted the wording around Tier 1 advice in RG 146 to mean that once the basic competencies for Tier 1 producers are met, an adviser is an expert in advising on the specific products they have met RG 146 Tier 1 requirements for. Instead, RG 146 requirements should be recognised as a starting point for training financial advisers. Higher competences and specialisation are essential and must be compulsory to ensure advisers improve their knowledge as well as continue their professional development.

Further, the industry has taken a simplistic compliance-driven approach to establishing adviser competence by substituting compliance with RG 146 for more comprehensive requirements for adviser competence. Licensees have not taken further action to check on an adviser's ability to provide financial advice in most cases other than requiring an adviser to have completed RG 146 requirements.

SPAA believes that there needs to be a cultural shift within the industry to embrace professionalism that encourages higher competencies rather than the current compliance driven approach. As highlighted above we believe that co-regulation is essential to achieve any cultural change.

Raise minimum education and competency standards for personal advice (including particular standards for more complex products or structures, such as SMSFs) and introduce a national examination for financial advisers providing personal advice.

SPAA supports increasing the minimum education and competency standards for personal advice but does not support the introduction of a national examination for financial advisers providing personal advice.

As previously mentioned, SPAA believes that an increase in education and competency standards for financial advisers will see an increase in the quality of advice being provided to consumers.

In relation to the setting of a national examination, SPAA is of the view that this would not improve financial adviser competency. The imposition of a national examination places a minimum standard hurdle that advisers are required to "jump over". Many licensees have shown that they accept minimum standards at best and therefore advisers will aim to pass only the imposed exam and not strive to undertake any further education or competencies at a higher level unless forced to do so.

While a national exam may attempt to ensure consistent assessment of competencies across financial advisers SPAA believes it would not improve competencies amongst financial advisers. We believe that the introduction of a national exam will have a similar effect to the existing RG 146 requirements – that is, education providers will develop courses that cater to an adviser passing the exam and licensees will merely accept passing the exam as the only requirement for competencies. Over time "what course should I do to pass to get me through the exam?" will become the question to ask when entering the industry rather than seeing the exam as a base which is required to be maintained by specialist qualifications and professional development.

Further, a national exam will only assess examinable "hard skills" such as technical knowledge. An exam will not be able to meaningfully assess the application of knowledge into practice (i.e. the adviser's ability to interact with clients). It is often the application of these "soft skills" (i.e. asking the right questions, understanding clients' needs and motivations, dealing with family circumstances, etc.) that are important in the provision of financial advice.

Further, a minimum standard national exam presumes that there is only one broad financial advice profession possible. SPAA has confirmed through research that there is an emerging SMSF profession and the Centre for International Finance and Regulation has acknowledged through its research that there are at least four sectors to consider within the financial system:

1. superannuation;
2. markets;
3. banking; and
4. insurance.

If there is a single exam across the entire financial services sector, all of these industry sectors would need to be accounted for generally in the exam. A single national exam for financial advisers does not take into account the development of a new profession or sector in the future or promote specialisation in a certain area of financial advice.

As described above, SPAA believes a co-regulatory approach is more appropriate to lift standards of financial advice through education and training. This approach would allow professional associations to drive professionalism by setting their members more difficult and stringent competency and training requirements. ASIC would approve professional associations that can regulate advisers as members under this framework. It would replace ASIC's needs to dictate minimum standards or set a national exam for the financial advice industry.

Ongoing continuing professional development (CPD) is a current requirement under RG 146. The need to undertake CPD is currently driven by a compliance based approach to advisers required to undertake a certain amount of CPD over a set period. This results in advisers often undertaking training that maintains their current knowledge just to get by, rather than extending and challenging them through new learning and improved knowledge. SPAA believes that if professional associations were tasked with setting the CPD requirements for their members, instead of ASIC, CPD would become more orientated to improving adviser's skills, rather than it being viewed as a mere compliance requirement by advisers and licensees.

SPAA provides the following two examples to evidence some of the issues around ASIC mandating minimum standards.

Example 1

ASIC introduced RG 146.

RG 146 sets out the minimum training standards that apply to advisers and how advisers can meet these training standards.

SPAA has identified that the majority of training and CPD courses offered to financial advisers stem from the requirements of RG 146 (and no more). These courses therefore promote educational training based on the minimum standards imposed by ASIC.

The ASIC Training Register held courses and training programs which had been ASIC approved and ranged from six months face to face programs (including exams) through to six hours for an online program. ASIC was not able to continue to regulate the ASIC Training Register (this was managed through an external accreditation body) and was abandoned three years ago. The industry has not had any formal guidance on courses and education programs from ASIC in the interim which has led to confusion in the industry in determining what programs or courses meet the minimum standards and who has been deemed to assess these courses.

The purpose of the ASIC Register was to support educators, licensees, individual assessment service providers and financial advisers to identify courses that were approved by ASIC to offer RG 146 accreditation. Once an adviser has been accredited, the list of ASIC's knowledge requirements detailed in Appendices A and B of RG 146, the register disappointingly serves to focus at a product and generic skills level to *maintain* competence. Furthermore, it does not adequately indicate that one needs to fully evaluate, assess and construct developmental objectives that build upon their existing strengths and areas for further development nor the progressive undertaking of more advanced CPD activities appropriate to their burgeoning responsibilities to meet consumers' needs.

RG 146 remains poorly understood by advisers, does not appear to be policed effectively and is driven by compliance and a 'tick box' mindset.

Example 2

Another example that has been even more evident to SPAA is in relation to the change of SMSF auditor registration.

The industry has changed from a professional approach which was overseen by appropriate organisations to one where an auditor meets the bare minimum requirements by completing a competency exam, as well as meeting other minimum requirements imposed by ASIC.

At SPAA we have seen a significant decline in the demand across the audit profession for SMSF auditor training and specialisation.

The SPAA SMSF Auditor registration and accreditation involves rigorous examination as well as ongoing CPD compliance requirements. Now that a mere minimum standard has been imposed by ASIC, many auditors are no longer seeing a need to be accredited and complete training and competencies at a higher level than just gets them over the line. Again, this drives behaviour within the industry with people simply seeking to meet the minimum standards.

SPAA has developed SMSF profession education programs, codes of conduct and disciplinary programs which underpin the SPAA Accreditation programs for SMSF Specialist Advisors (SSA) and SMSF Specialist Auditors (SSAud which is recognised in the SIS Regulations and ASIC Auditor Registration program).

Introduce an enhanced public register of financial advisers (including employee advisers) which includes a record of each adviser's credentials and current status in the industry, managed either by Government or industry.

SPAA strongly supports the introduction of an enhanced public register of financial advisers (including employee advisers) which includes a record of each adviser's credentials and current status in the industry.

In order for a public register to be effective, it is imperative that it contains a range of information including:

a) the details of the adviser; name, contact details, employment details and duration of employment with each employer;

b) an adviser's professional association membership details;

c) any approved professional association accreditations (i.e. only those accreditations which are approved by the regulator to be on the register);

d) education and qualification details relevant to financial planning;

e) details of ownership of the adviser's employer/licensee; and

f) details of any sanctions or disqualifications, stemming back at least 5 years.

If a register contained less than the above information, SPAA is of the view that it would deprive consumers of any true benefit. It would not provide consumers with access to required information to make an informed decision on whether to proceed with a particular adviser or licensee.

A research study published by SPAA and Russell Investments in February 2014 Z "Intimate with Self-Managed Superannuation" (the SPAA/Russell Report), indicated that consumers are interested in the education, training, experience and independence of an adviser when selecting an SMSF adviser. Accordingly, we believe that an enhanced register would be valued used by consumers.

Enhance ASIC's power to include banning individuals from managing a financial services business

SPAA would support an increase to ASIC's powers to include banning individuals from managing a financial services business. We are of the view it is imperative that such a power exists so that those who are not considered to be fit and proper to run such business be prevented from doing so. Without this power, ASIC would be unable to prevent certain people from managing a financial services business. This would create a threat to consumers who unbeknown to them, may be dealing with a financial services business run by someone who may have been found guilty of fraud or deception (for example). We do realise, however, that ASIC is underfunded and under-resourced in this area. Therefore, current resourcing issues as well as resourcing of any new initiatives will need to be addressed before any further powers are delegated to ASIC.

> The Inquiry seeks further information on the following areas:
>
> - What opportunities exist for enhancing consumer access to low-cost, effective advice?
> - What opportunities are there for using technology to deliver advice services and what are the regulatory impediments, if any, to those being realised?
> - What are the potential costs or risks of this form of financial advice, and what measures could be taken to mitigate any risks?

The ability for consumers to access scaled advice on narrow financial issues is a critical feature in allowing consumers to access low-cost, effective advice.

SPAA believes that if technology is embraced by advisers, there may be opportunities to streamline certain processes and procedures. In turn, this may reduce overheads to advisers and reduce the cost of advice to consumers if those savings are passed on.

Research undertaken by SPAA and Macquarie Bank showed that improved technology and automation in the SMSF administration space have allowed SMSF advisers to reduce costs and pass savings on to clients.[26]

Using mobile devices such as tablets can allow advisers to have information and documents available at the ready reducing administrative time and costs. There may also be a cost saving of having documents available in electronic format, as opposed to having to print them out. Some consumers may also prefer having documents emailed to them rather than in hard-copy format.

One example might be for advisers to electronically provide SoA to consumers. This may provide a much quicker and effective means to deliver a SoA and allow delivery in circumstances where physical delivery is impractical or a consumer requires the SoA quickly.

The *Corporations Act 2001 (Cth)* does not prevent the delivery of a SoA electronically. Division 3 of Part 7.7 of the *Corporations Act* sets out the requirements in relation to an SoA and one of the requirements is that the SoA must be presented in a clear, concise and effective manner (sections 947B(6) and 947C(6)). However, there is no distinction between having to provide the SoA in hardcopy or electronically. Other obligations in relation to the SoA include the requirement to retain the SoA or other documents mentioned therein for 7 years from the day on which the SoA is provided to the client (regulation 7.7.09C of the *Corporations Regulations 2001 (Cth)*); however, there is no explicit prohibition on retaining these by electronic means.

Further, SPAA supports innovative use of technology to interact and advise clients where it is done in a suitable manner, especially if this can reduce costs and engage more consumers. We believe that a principles based approach to regulating financial advice provided through technology must be developed. Any such approach must balance expanding the reach of financial advice and ensuring that advice delivered through technology is still appropriately tailored to an individual's circumstances.

The Inquiry seeks further information on the following areas:

- Is there is a case to more clearly distinguish between independent and aligned advisers, and what options exist for doing this?
- Would consumers be likely to understand the difference between aligned and independent advisers and, if so, to what extent would this be likely to factor into a consumer's decision to take the advice?
- Would consumers be likely to be sensitive to differences in the price of independent or aligned advice?

[26] SPAA/Russell Investments, Intimate with SMSFs 2014.

Is there is a case to more clearly distinguish between independent and aligned advisers, and what options exist for doing this?

As set out in our first submission to the Financial System Inquiry, we believe independent advisers can be more clearly delineated through increased disclosure requirements. Improved disclosure requirements would assist consumers in understanding whether they are receiving advice or product recommendations provided on an independent basis or whether it is provided on the basis of an approved product list or through a vertically integrated firm.

In order for disclosure to be effective in better distinguishing between independent and aligned advisers, very clear and effective categories need to be constructed to "label" advisers. Also, disclosure of whether an adviser is aligned or independent must be very clear and upfront to consumers. Otherwise, disclosure will have limited effect in raising consumer awareness as to whether an advisor is independent or not. SPAA notes that there are limitations on disclosure as an effective consumer protection tool and believes that having very clear categories and rigorous disclosure rules are needed for disclosure be an effective policy.

Further, as discussed above, a register of financial advisers should include information on independence and alignment to ensure consumers can easily access information on the independence of their financial adviser.

We believe it is up to an individual consumer to decide on whether independence of a financial adviser will impact their decision on whether the relevant advice meets their needs. Improved disclosure as to whether an adviser is aligned or independent would allow consumers to be more informed in deciding whether the financial advice they are receiving is fit for purpose and offers them the best value. Providing consumers with this information will also allow them to judge whether the information or recommendations made to them are in their best interest and will assist them to achieve their financial goals.

Another proposal to create greater distinction between aligned and independent advisers is to create a separate licencing category for independent advisers. This would make independent advisers clearly visible to consumers who want to seek out an independent financial adviser.

Also, we believe that through co-regulation and increasing professionalism, independence would naturally grow in the industry. There would be less reliance on dealer group arrangements and advisers would start to become more personally accountable for their actions, as evidenced by other professional groups.

Would consumers be likely to understand the difference between aligned and independent advisers and, if so, to what extent would this be likely to factor into a consumer's decision to take the advice?

We believe that consumers would easily be able to understand the difference between aligned and independent advisers where the terminology assigned to the categories is clear. This coupled with better disclosure by advisers would certainly ensure consumers understood whether their adviser was independent or aligned. We believe this distinction between advisers would certainly play an important factor for many people in choosing an adviser. Some consumers may only be willing to deal with an adviser who is truly independent, whilst others may not place as much emphasis on this. SPAA's view is that consumers should at least be able to easily distinguish advisers and for them to decide whether it is an important factor in deciding which adviser to engage.

The SPAA/Russell Report states that the top three key factors considered by trustees when looking for a financial adviser are:

1. investment expertise;
2. independence; and
3. recognised professional qualifications.

Would consumers be likely to be sensitive to differences in the price of independent or aligned advice?

Finally, we believe that consumers will take into account price differentiation between independent and aligned advisers which will encourage greater competition in the marketplace. SMSF trustees are willing to pay for high quality advice as revealed in the SPAA/Russell Report which stated "…three quarters of trustees in 2013 [said] they would be willing to pay a professional for specialist services".

> The Inquiry would value views on the costs, benefits and trade-offs of the following policy options:
>
> - No change to current arrangements
> - Rename general advice as 'sales' or 'product information' and mandate that the term 'advice' can only be used in relation to personal advice.

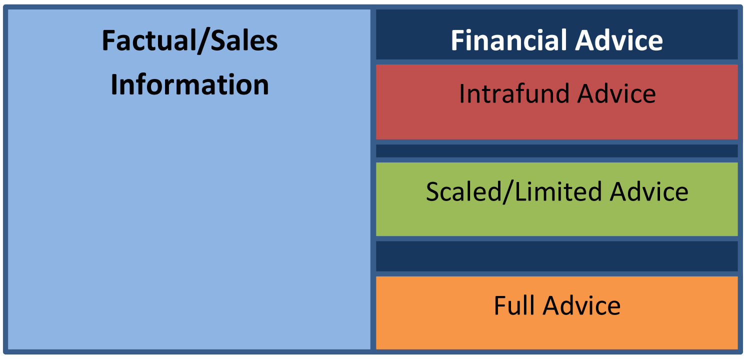
As set out in our first submission to the Financial System Enquiry, SPAA believes that there needs to be a clearer distinction between what is 'financial advice' and what is 'factual' or 'sales' information. Such a distinction would allow consumers to better understand the information provided by a financial adviser or employee of a financial services firm.

We believe that a clearer distinction between factual/sales information and financial advice which is tailored to an individual's circumstances would assist consumers in understanding the nature of the advice/information they are being provided with. Such a split would see current factual information or general advice fall under factual/sales information while personal advice would be considered as financial advice. This would lead to consumers having greater awareness of whether they are receiving financial advice that takes into account their personal circumstances and financial goals or whether they are being provided with factual information or sales information which explains or is marketing a product.

Therefore, in this regard, we would support the proposed renaming of general advice to "sales" or "product information". In addition to renaming the existing general advice category it would be prudent to reconsider where the "dividing line" between sales and product information and personal financial advice falls. For instance, should the provision of product information allow explanation of the general benefits and risks of a product, or should it be limited to merely explaining the features of a product without any subjective information being provided (i.e. this is a good product because…)?

As set out in our first submission to the Financial System Enquiry, the proposed advice framework could be illustrated as:

Proposed advice framework



SPAA notes that there will be flow on effects that will need consideration with the above suggested changes. For example:

- Reviewing and upgrading the current RG 146 educational requirements to be appropriate to provide product/sales information.
- Introducing a simpler licensing requirement for those providing product/sales information.
- Reviewing Professional Indemnity insurance for anyone providing purely product/sales information.

SPAA believes that as there are a number of issues for consideration, they would best be dealt with by an industry working group. SPAA would welcome the opportunity to be part of such a group.

As part of the licencing system, to make sure it better serves consumers, it would also be worthwhile to review what products are included under the *Corporations Act 2001* definition of financial product. This definition determines what products are regulated under the advice rules. With certain types of financial products being included (i.e. superannuation, equities, life insurance, managed investment products, etc.) and others being excluded (property, general insurance, LRBAs), the current settings can be confusing for consumers to the extent that they may be misleading.

Funding

Infrastructure funding

The Inquiry seeks further information on the following area:

- What are the impediments to the development of liquid, tradeable claims on infrastructure projects?

As SPAA stated in our initial submission to the FSI, SMSFs can have a substantial impact on funding infrastructure investments and there is likely to be an increase in demand by SMSF investors in infrastructure assists if appropriate products are developed.

SPAA believes that opening up infrastructure investments to SMSFs in a unitised, liquid form would provide a new avenue for SMSF investment that could assist SMSFs in managing longevity while also funding Australia's future investment needs. The desire for control through direct investing and the desire to use alternatives to cash and term deposits by SMSF trustees will encourage investing in infrastructure as an attractive investment option. SMSF investors are also traditionally "sticky investors" that undertake investments with a long-term investment time frames in mind. This makes SMSFs suitable for investing in infrastructure if the product is appropriately structured.

Infrastructure investments act as an important investment class that offers a risk-return point between cash/fixed interest and equity investments. This is attractive as younger demographics enter the SMSF space and a need for longer term investments arises due to increased life expectancies amongst the overall population. With SMSFs predicted to grow to asset holdings of $2.23 trillion by 2033,[27] and currently around one-third of SMSF assets held in low-risk assets, we expect the SMSF low risk capital pool to grow to approximately $725 billion. This large pool of low-risk preferred capital would be a viable source of infrastructure funding in years to come.

Currently SMSFs are extremely limited in investing directly in infrastructure due to the high dollar threshold for infrastructure investment and the illiquid nature of the required investment. SPAA believes that addressing these liquidity issues and removing administrative barriers will provide the most significant challenges in allowing SMSFs to have better opportunities to invest in infrastructure projects.

Unitising investment in infrastructure projects in smaller parcels or lower value products for SMSFs (e.g. $25,000 units) would be one way to overcome current limitations, as would be issuing small-scale infrastructure bonds. Developing a secondary market in these products

[27] Deloitte, Dynamics of the Australian Superannuation System: The next 20 years: 2013 – 2033.

would allow SMSFs to manage liquidity risks, especially when they are in the retirement phase, so they can meet changing needs to realise their SMSF capital to generate income. Alternatively, ASX listed infrastructure funds could provide SMSFs access to infrastructure, and infrastructure projects access to SMSF funds, plus address the liquidity issue.

Opening infrastructure investment to SMSFs would also have another benefit of offering SMSFs investments that can be used to fund income streams in retirement. SMSF trustees are looking to manage longevity risk by accessing long term investment options with low volatility, moderate yield relative to inflation and moderate capital growth. Infrastructure investments meet this profile. As detailed in our section on retirement income in this submission, allowing SMSF trustees greater access to investment types that allow them to generate stable income streams will allow them self-manage longevity risk and generate retirement income.

Growth of superannuation

The Inquiry seeks further information on the following area:

- What effects will the trends in the size and composition of superannuation have on the broader flow of funds in the economy over the next few decades, including on international capital flows to and from Australia?

SPAA reiterates our contention in our initial FSI submission that superannuation will increasingly become an important source of capital funding in the Australian economy. In particular the SMSF sector will increasingly become an important source of capital funding within the Australian economy.

Of the current $1.85 trillion pool of superannuation assets, SMSFs hold an estimated $557 billion of assets as of June 2014[28]. The $557 billion of assets are held by 534,176 SMSFs. SMSFs already hold a significant sum of capital, with this amount to grow as the superannuation sector matures. With the superannuation sector forecast to have total superannuation assets increasing steadily to $7.6 trillion by 2033, SMSF asset holdings are projected to increase to $2.23 trillion over that time.

The sheer size of assets currently held by SMSFs and the growth of these asset holdings over the next 20 years will mean that SMSFs will offer a viable funding source of capital to fund investment within the Australian economy. Accordingly, we believe that any policy development on how Australia's capital pool will develop over the long-term needs to consider the SMSF sector as an important source of funding.

[28] APRA, Quarterly Superannuation Performance (interim edition) June 2014 http://www.apra.gov.au/Super/Publications/Documents/June_2014_Quarterly_Superannuation_Performance.pdf?WT.si_cs=1.

Corporate Bond Market

> The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:
> - No change to current arrangements.
> - Allow listed issuers (already subject to continuous disclosure requirements) to issue 'vanilla' bonds directly to retail investors without the need for a prospectus.
> - Review the size and scale of corporate 'vanilla' bond offerings that can be made without a prospectus where the offering is limited to 20 people in 12 months up to a value of $2 million, or for offers of up to $10 million with an offer information statement.

SPAA supports greater development of Australia's corporate bond market and greater access for retail investors, such as SMSF trustees, to investment in corporate bonds.

Deepening of and access to the corporate bond market for SMSFs would allow SMSFs to diversify their low-risk holdings from cash and term deposits into other low-risk, steady-return products. As of March 2014, only 0.75% of SMSF assets were invested in debt securities compared to 27.96% in cash or term deposits.[29]

Accordingly, SPAA supports allowing listed issuers to issue vanilla bonds without prospectus where the bonds being issued are simple and easily understood by retail investors. Similarly, SPAA would support a review of the size and scale of corporate 'vanilla' bond offerings that can be made without a prospectus where the offering is limited to a small size and scale.

A deeper corporate bond market, with access for smaller investors, would allow Australian corporations access to Australian capital and reduce dependence on overseas debt funding. Allowing superannuation to provide more debt financing to Australian companies through corporate bonds will become increasingly important as superannuation assets grow to exceed those of the banking sector.

> The Inquiry seeks further information on the following areas:
> - As a greater share of the population enters retirement, would the demand for fixed income products increase in the absence of regulation or other incentives?
> - Would the development of annuity-style retirement income investment products encourage the growth of fixed income markets?

SPAA believes that demand for fixed income products will continue to grow as Australia's demographic shifts to more people being in retirement. As explained in our comments on

[29] ATO, Self-managed super fund statistical report – March 2014.

retirement income policy, greater access to appropriate underlying investments, such as fixed interest investments, will allow retirees greater opportunity to manage retirement income and longevity risks. We believe that this increase in demand will occur without regulation or incentives, but note that making the issuance of corporate bonds easier will help ensure that demand is met. Also, Government provision of long-term and inflation linked bonds will also meet demand for fixed income products.

Development of annuity-styled retirement income investment products will encourage the growth of fixed income markets. However, SPAA believes that the demand for fixed income products will grow independently of product development because those that self-manage retirement income, such as SMSF trustees, will demand more fixed interest investments. Accordingly, we believe that the development of Australian fixed interest markets (both corporate and Government) should not rely on increased provision of annuity products. We believe it is important to develop the bond market for those that want to self-manage longevity risk and retirement income.

As explained in our section on retirement income, SPAA believes that the existing retirement income system is not fundamentally underdeveloped but can be improved to provide better outcomes for retirees. One of the key enhancements that can be made is improving the availability of better underlying investment options for retirees to manage retirement income with. A necessary development to improve the availability of underlying investments that meet the need of retirees is the development of deeper fixed income markets.

Access for retail investors to new equity offers

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Review the size and scale of offerings that can be made without a prospectus where the offering is limited to 20 people in 12 months up to a value of $2 million, or for offers of up to $10 million with an offer information statement.
- Introduce additional protections for investors in relation to use of private placements and non-renounceable rights issues.

SPAA supports greater access for retail investors to new equity offers. This will be especially important as funds under management of SMSFs increases over time, making SMSFs a significant funding source for Australian companies.

SPAA believes that improving technology solutions, such as the ASX mFunds platform and ASX BookBuilds, are offering smaller retail investors, such as SMSFs greater opportunities to invest in new equity offers. It is important that there are no regulatory impediments to stopping technology allowing greater access to new equity offers for retail investors.

Consumer loss and compensation

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options:

- No change to current arrangements.
- Amend the existing regulatory framework for managed investment schemes.

The Inquiry seeks further information on the following area:

- Given the limitations of professional indemnity insurance, what options, if any, exist for addressing the issue of consumer loss?

SPAA has advocated and continues to advocate for a last resort compensation scheme for the financial services sector. SPAA previously outlined its position and its suggestion as to how a last resort compensation scheme would function in its submission to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the collapse of Trio Capital and any other related matters on 25 August 2011.

Also, SPAA does not support an SMSF compensation scheme based on an annual SMSF compensation levy. We believe that this would be an ineffective solution to SMSF failure as SMSF trustees should not be responsible for other trustees' decisions or the improper behaviour of financial services firms.

SPAA recommends that an industry based last resort compensation scheme should be introduced for the financial services sector with the following key features:

a) It should provide limited "last resort" financial compensation in situations where a client has suffered financial loss as a result of the misconduct or insolvency of a AFS licensee;

b) The compensation could be on funded or pay as you go basis. If a funded basis was adopted the fee could be included in any fee payable to the regulator at the time of lodging documents for approval. If a pay as you go basis was adopted then the levy would be imposed after the relevant event a on the industry sector which was the cause of the financial failure;

c) The characterisation of industry sectors should be sufficiently broad to include Managed Investment Scheme providers and manufacturers;

d) Compensation levies on a funded basis could be actuarially determined based on the risk of the relevant products and the likelihood of failure;

e) The scheme should be sufficiently flexible to allow excessive compensation claims to be funded by a levy imposed on a linked industry sector.

SPAA is adamant that it is still important a last resort compensation scheme be implemented to protect all consumers of financial advice and financial services. In SPAA's view there is inadequate protection against misconduct and insolvency of an Australian

Financial Services (AFS) licensee for those who invest through SMSFs as opposed to other investment vehicles. SMSF members are mostly retail investors who are less able to absorb capital losses when compared with larger funds of the kind regulated by APRA. SMSF members are similar and aligned to aspirations of ordinary investors in the marketplace. This differs from APRA-regulated fund members where the function of the trustee and investment managed is not integrated with the fund members.

The exposure of consumers, in particular SMSF trustees, to fraud and dishonest conduct by AFS licensees and product providers has been illustrated by the recent failures in Trio Capital, Storm Financial, Opes Prime and Westpoint. These cases have illustrated the weaknesses of relying on external dispute resolution schemes and mandatory professional indemnity insurance for consumers, especially SMSFs trustees who are not eligible for Part 23 SIS Act compensation.

SPAA believes that the weaknesses of current compensation arrangements for investors that has incurred financial losses by no fault of their own due to a financial adviser or product provider acting fraudulently or dishonestly is not acceptable. The fairest and most appropriate method to remedy this problem is to introduce a last resort compensation scheme. In SPAA's view, if a funded last resort compensation scheme was in place prior to the Trio Capital collapse, it would have provided appropriate compensation to SMSF investors and other similar investors who under the current regime received little or no compensation.

SPAA does not agree with the findings of the Richard St John report, that the introduction of a last resort compensation scheme would be inappropriate and possibly counter-productive. However, SPAA does agree with the report's assertions that implementing a last resort compensation scheme could result in regulatory moral hazard and that the 'light-handed' regulation of financial advisers and other licensees – especially in regards to professional indemnity insurance – needs to be resolved. We believe that these issues can be dealt with appropriately and should not impede the introduction of a last resort compensation scheme. SPAA believes the core solution to resolving these issues is ensuring a better coverage and better regulation of professional indemnity insurance held by AFS licensees.

In relation to compensation schemes, many of the arrangements have involved a range of conflicts due to the commonality of links between parties involved from the manufacturer to the retail investor. These conflicts should be resolved so that each link in the chain operates objectively and independently. In many cases the outcome has been to 'pass the buck' to the Financial Ombudsman Service which is unacceptable. We believe that any indemnity insurance in this area should have set criteria which must be covered to prevent such actions occurring.

Improved professional indemnity insurance

SPAA believes that ensuring AFS licensees hold proper and adequate professional indemnity insurance is an important step in resolving the inadequacy of the current compensation arrangements for investors that suffer a loss due to fraudulent behaviour or dishonesty. The financial losses of investors, especially SMSF trustees, incurred due to the dishonest behaviour of some financial advisers relating to advice on Trio Capital, revealed the problems of AFS licensees not having adequate professional indemnity insurance.

SPAA has advocated for more stringent enforcement of professional indemnity insurance in its submission to the Trio Inquiry. SPAA noted in its submission that ASIC's general approach to insurance arrangements of AFS licensees relies on licensees self-assessing the adequacy of their professional indemnity cover taking into account the guidance in ASIC's RG 126. Licensees are required to provide ASIC with information about their insurance cover and a certificate of currency as part of their license application process but they are not required to provide ASIC with a copy of their professional indemnity insurance policy.

Furthermore, once a licence is granted, the licensee's insurance cover is not subject to annual or other periodic review (unless the licensee advises ASIC that they are no longer able to meet their licence obligations).

SPAA believes that a periodic and more systematic approach by ASIC in the monitoring and assessment of insurance policies held by licensees is necessary. At the very least, SPAA believes that licensees should be required on an annual basis to show how their insurance arrangements satisfy the requirements as set out in RG 126.

SPAA also supports the creation and promotion of standard professional indemnity insurance policies as a way of reducing the transaction costs and associated risks for licensees and consumers. Standard insurance policies would also encourage insurers to develop policies that can cover in similar situations. Standard insurance policies may also address the general lack of run-off cover which exists in the financial services sector and which is a significant weakness in the reliance on professional indemnity insurance.

Ensuring an appropriate standard of professional indemnity insurance in the financial services sector and a more systemic regulatory approach by ASIC would resolve many of the issues experienced by investors who have suffered financial losses in the past due to the misconduct of their financial adviser. It would also pave the way for the introduction of a last resort compensation scheme for the sector as proposed above.

Assuming the last resort compensation scheme would be funded by an industry levy based primarily on past events and actuarially determined, the requirement for AFS licensees to hold appropriate levels of insurance cover would ensure a last resort compensation levy for the sector would be minimised.

Increasing the regulation and oversight of AFS licensee professional indemnity insurance will ensure that if a last resort compensation scheme was in place, fewer claims would need to be compensated through the compensation scheme. This would result in lower industry levies needing to apply to the different sectors that would fall under a financial services last resort compensation scheme. Lower levies would most likely result in acceptance of a last resort compensation scheme by AFS licensees. SPAA believes that this would be a significant factor in being able to successfully introduce a last resort compensation scheme and also run it in a low-cost manner.

Similarly, the risk of regulatory moral hazard which was referred to in the final Richard St John report as a consequence of introducing a last resort compensation scheme would be reduced by the introduction of professional indemnity standards and a more heavy handed regulatory approach. By requiring AFS licensees to hold appropriate and adequate professional indemnity cover, proper regulation can reduce the risk that AFS licensees will not hold adequate insurance and instead rely on the existence of a last resort compensation scheme. We contend that ensuring AFS licensees have appropriate insurance cover will reduce the chance of moral hazard occurring if a last resort compensation scheme were introduced. Also, there should be minimum levels of professional indemnity insurance which compulsorily cover certain events. We also contend that all avenues relating to an adviser's professional indemnity insurance are exhausted prior to referral to the Financial Ombudsman arrangements.

Requiring AFS licensees to hold appropriate professional indemnity insurance should be a major pillar in ensuring that investors have adequate protection from fraud and dishonesty. SPAA agrees with the Richard St John report's assertions that the current regulation and checking of AFS licensee professional indemnity insurance is lax and allows for irresponsible licensees to have inappropriate insurance arrangements.

We believe that if there was more regulatory scrutiny by ASIC of AFS licensees, the financial services industry would have greater professional indemnity insurance coverage resulting in more appropriate compensation outcomes for investors. Consequently, we believe that ASIC should be appropriately resourced to properly scrutinise whether AFS licensees are holding proper and adequate professional indemnity insurance.

Regulatory Architecture

SPAA would like to take this opportunity to again reassert that the current regulatory settings for the broader superannuation sector and SMSFs is correct and provides appropriate outcomes in relation to the character of SMSFs. The roles of APRA, ASIC and the ATO in regulating different superannuation entities is the right fit and should be maintained.

The continued prudential supervision by APRA of large superannuation funds that have trustees unconnected with members managing a member's retirement savings on their behalf is appropriate. Similarly, the compliance focussed regulation of SMSFs by the ATO is the correct approach for the regulation of SMSFs. SPAA believes there is no need to change compliance orientated regulation which was adopted as a result of the Wallis Inquiry recommendations in 1997.

There have been calls for SMSFs to be prudentially regulated as well as regulated from a compliance perspective in order to manage any systemic risk the sector poses. SPAA does not support the prudential regulation of SMSFs because it is incongruous to the nature of SMSFs where trustees as required under the SIS legislation to manage their own retirement savings. It is not appropriate for SMSFs as it would lead to less supervision of the sector where breaches of technical matters may have a material impact on the fund complying with the SIS legislation. Prudential regulation is appropriate where money is being managed on behalf of another person who has little ability to influence the trustee responsible for managing their retirement savings.

SPAA acknowledges that the ATO's SMSF regulatory activities have been appropriate and are effective to the extent that SMSF trustees are complying with the taxation and superannuation laws. ATO statistics show that SMSF audit contravention reports (ACRs) (required when an SMSF has contravened a specified SIS Act provision) remain low with the ATO stating that "the percentage of the SMSF population with ACRs remains relatively stable at approximately 2% of all SMSFs each year."[30] Further the ATO reported that "just under half of all contraventions were reported as rectified."[31] This illustrates that the ATO are doing a good job and SMSFs are being administered responsible and within government policy objectives.

Furthermore, the level of serious non-compliance by SMSF trustees is low. In 2012-13 the ATO made 150 SMSFs non-complying, disqualified 440 people from being trustees, prevented 191 potential SMSFs from entering the system, wound up 70 funds as a result of audit action, entered 513 enforceable undertakings, and removed 438 SMSFs suspected of

[30] ATO, Self managed Superannuation Funds: A Statistical Overview 2011-12.

[31] ATO, Self managed Superannuation Funds: A Statistical Overview 2011-12.

illegal early release from Super Fund Lookup while they were under investigation.[32] In a pool of over 500,000 SMSFs, this is a very low level of non-compliance and demonstrates that current supervisory arrangements are acceptable and appropriate.

We believe that the ATO's current approach to SMSF regulation is successful and will only be enhanced by the new SMSF administrative penalty regime that commenced on 1 July 2014 which gave the ATO a more complete suite of compliance measures to regulate SMSFs with.

More practically the ATO is an appropriate regulator of SMSFs due to their ability to undertake large scale processing to regulate over 500,000 SMSFs which are continuing to grow at a reasonable rate. Moving the SMSF regulatory function to another regulator would require building a knowledge base and developing technological capacities to be able to manage regulating over 500,000 entities.

Conduct regulation: fund administrators and technology service providers

The Inquiry seeks views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Impose AFSL requirements for providers of fund administration and technology service of sufficient scale.
- Apply market integrity rules for licensed securities dealers that provide investor services substantially similar to market participants of a licensed financial market.
- Introduce a mechanism to allow a heightened level of regulatory intensity to be applied where risk arises outside the conduct perimeter.

SPAA believes that some changes are required and therefore does not support the proposition that there is no change required.

***Impose AFSL requirements for providers of fund administration and technology service of sufficient scale*.**

While SPAA does believe that some changes are required, SPAA does not support having fund administrators and technology service providers subject to AFSL requirements.

As part of the Cooper review in 2010, the issue of having fund administrators registered was considered. The report stated:

[32] Alison Lendon, ATO, 'Regulating SMSFs: a cooperative exercise' http://www.ato.gov.au/Media-centre/Speeches/Other/Regulating-SMSFs--a-cooperative-exercise/.

> *Consistent with the approach for other prudentially regulated industries, the Government does not support APRA licensing of service providers such as administrators or clearing houses. Instead, the Government supports heightened requirements for trustees who deal with administrators and will refer the need for prudential standards in this area to APRA for consideration.*

SPAA agrees with the findings of the Cooper review in this respect and believes that there are myriad of issues which would arise should fund administrators be required to obtain an AFSL. There would be issues, for example, in determining what is a fund administrator and to what extent anyone involved in the administration of a SMSF would be required to obtain an AFSL (for example lawyers and/or law firms who deal with creating the trust deeds may be seen as administrators).

There are also a number of other issues arising such as:

a) what would the registration and licensing be aimed at;

b) as mentioned above, there would be difficulty in defining what an 'administrator' is and what their functions would be;

c) potential consolidation of the SMSF space;

d) transfer of the role of accountants to administration companies;

e) the role of professionals to date has shown no market failure in the administration of SMSFs;

f) the accountants role is an advising role with clients which is a one on one arrangement not only about superannuation but also on a whole range of issues concerning the client's personal affairs;

g) accountants may end up with a reduced role with SMSFs and may lose interest in them;

h) handing the SMSF function to financial planners who are conflicted by vertical integration may be a problem;

i) if this is to be considered seriously then there is a need to implement any licensing arrangements until the FOFA and other reforms have settled.

In addition, SPAA's concern with this would be whether the cost of obtaining an AFSL and compliance with the AFSL by these providers would be added to the cost to the consumer. There has been concern expressed that the cost of setting-up and maintaining a SMSF is too high (a view with which SPAA does not agree), therefore any increase to costs of administration need to be carefully considered. Further, the current robust competition in the SMSF administration market is leading to improved technology and more efficient administration being offered to SMSF trustees. SPAA would be wary of any regulatory changes that decrease competition in the SMSF administration sector.

There may be scope for introducing a regulatory framework for these providers without imposing the need for them to have to obtain an AFSL. This may reduce the compliance cost and burden but ensure that there is some regulation around the service that is provided.

Finally, we note that there has been no significant failure in the fund administration sector at present and have not observed a build up in systemic risk in fund administration. Also, the SMSF fund administration sector is currently going through a period of significant change with the introduction of disruptive digital technology and consolidation through acquisitions. We believe any changes to the regulation of fund administrators should be only made once the SMSF administration sector emerges from its current phase.

Apply market integrity rules for licensed securities dealers that provide investor services substantially similar to market participants of a licensed financial market.

SPAA would support applying market integrity rules for licensed security dealers that provide investor services substantially similar to market participants of a licensed financial market.

Introduce a mechanism to allow a heightened level of regulatory intensity to be applied where risk arises outside the conduct perimeter.

SPAA would support a mechanism to have higher risk products reviewed and approved by an independent body. This would ensure that these products which are considered to be high risk are formally reviewed and a determination made whether it is an appropriate investment choice for SMSFs. If this is adopted, it would need to be made abundantly clear to consumers that the role of the independent body is not to certify any level of investment return, but to simply determine whether the product should be released to the market as fit for purpose.

Independence and accountability

Observation
Australia generally has strong, well-regarded regulators but some areas of possible improvement have been identified to increase independence and accountability.

SPAA agrees with this observation.

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Move ASIC and APRA to a more autonomous budget and funding process.

SPAA would support a review of the functions of the current agencies as set below.

SPAA does not support moving ASIC and APRA to a more autonomous budget and funding process as this would likely see an increase in fees for market participants. Further, an autonomous funding process will likely be less transparent than current arrangements, and would not be subject to budget controls that currently apply. This would effectively give regulators monopoly coverage of the market and be in a position to charge what they like.

This would likely mean that SMSFs, advice and associated functions would bear a disproportionate cost rather than the larger corporations who usually have a cap placed on fees (e.g. the APRA levy).

SPAA believes that it would be more appropriate to perhaps review the functions of each agency to determine whether they are fit for purpose. As an example, consideration should be given as to whether ASIC should have the responsibility for corporations and financial services including advice. The latter is a consumer function that could be administered by a body that is more attuned to consumer aspirations or sits within a more specialised division of ASIC.

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Conduct periodic, legislated independent reviews of the performance and capability of regulators.
- Clarify the metrics for assessing regulatory performance.
- Enhance the role of Statements of Expectations and Statements of Intent.
- Replace the efficiency dividend with tailored budget accountability mechanisms, such as regular audits and reviews to assess the regulators' potential for savings.
- Improve the oversight processes of regulators.

Conduct periodic, legislated independent reviews of the performance and capability of regulators.

SPAA strongly supports this proposal that periodic independent reviews are undertaken of the performance and capability of regulators. This will ensure that agencies are modified as appropriately identified over time to be fit for the purpose intended. It will also enable the role of the regulator to be reviewed to ensure that any legislative updates are being complied with.

Clarify the metrics for assessing regulatory performance.

Clarifying the metrics for assessing regulatory performance is important, as the role of the agency may not be articulated correctly.

Enhance the role of Statements of Expectations and Statements of Intent.

SPAA supports enhancing the role of Statements of Expectations and Statements of Intent. This would ensure that agencies are clear about government policies and objectives including what the agency is expected to observe in conducting its functions.
Statements of Expectations and Statements of Intent could be more effectively used as a benchmarking tool to assess the performance of the agency in carry out their core responsibilities.

Replace the efficiency dividend with tailored budget accountability mechanisms, such as regular audits and reviews to assess the regulators' potential for savings.

SPAA supports the abolishment of the efficiency dividend as it fails to recognise changes in market conditions and is an arbitrary political adjustment merely for fiscal reasons.

Improve the oversight processes of regulators.

Improving the oversight of regulators is critical to ensuring the industry as a whole is working correctly. SPAA supports tighter oversight procedures and mechanisms.

Execution of mandate

The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Strengthen competition considerations through mechanisms other than amending regulators' mandates.
- Refine the scope and breadth of ASIC's mandate.
- Review the penalty regime in the Corporations Act.
- Review mechanisms to attract and retain staff, including terms and conditions.

SPAA believes that the current regulator arrangements can be improved so does not support an option of no change to current arrangement

Strengthen competition considerations through mechanisms other than amending regulators' mandates.

SPAA would support the strengthening of competition considerations through mechanisms other than amending regulators mandates. Existing mandates, especially ASIC's in regard to financial services, are already broad and any further expansion of mandates would inhibit regulators' abilities to successfully achieve their current policy goals.

Refine the scope and breadth of ASIC's mandate.

A review and refinement of the scope and breadth of ASIC's mandate would be welcomed by SPAA. SPAA believes that it is important to have an organisation that is fit for purpose which may require shedding of consumer based functions such as financial planners, registration of auditors and registration of licensees from its ambit. Further, ASIC's broad mandate can often result in it its objectives competing with each other, especially its goals of maintaining market integrity and providing for consumer protection.

As explained below, SPAA believes that some of ASIC's functions in relation to consumer protection could be passed to the Australian Competition and Consumer Commission (ACCC).

Review the penalty regime in the Corporations Act.

SPAA would welcome a review of the penalty regime in the Corporations Act.

Review mechanisms to attract and retain staff, including terms and conditions.

SPAA believes that it is crucial that regulators attract and retain highly skilled, technically advanced and motivated individuals in order to provide a high level service going into the future. In order to ensure that this occurs, remuneration and conditions of staff need to be competitive compared to the salaries offered in Australia's financial sector.

Whilst salaries offered within the public sector are often seen to be higher for individuals early on in their careers, this becomes the converse as people become experienced. We believe that this in fact encourages individuals to leave the public service once they have built up technical expertise; a behaviour that we believe should be discouraged in view of the loss of knowledge and experience. As mentioned, this is usually because experienced individuals are highly sought after and are offered much higher salaries elsewhere within the industry.

In order to remain competitive and retain highly skilled staff, the remuneration provisions may need to be reviewed. There may also need to be new provisions dealing with rewarding excellent staff who demonstrate extraordinary abilities in their field.

The Inquiry seeks further information on the following areas:

- Are changes needed to strengthen and/or refocus ASIC?
- Is the current enforcement regime adequate? Does ASIC have adequate powers?
- Are there alternative mechanisms for promoting better consideration of competition within financial sector regulation?

Are changes needed to strengthen and/or refocus ASIC?

Yes, for the reasons already mentioned, a refinement of ASIC's scope of powers and ambit are required and welcomed by SPAA.

Is the current enforcement regime adequate? Does ASIC have adequate powers?

The key issue is enforcement and lack of action especially with the larger entities. Whilst SPAA acknowledges ASIC is underfunded and under resourced, enforcement is often an area that is overlooked due to these issues.

Are there alternative mechanisms for promoting better consideration of competition within financial sector regulation?

SPAA believes that it may be prudent to consider that the ACCC take a greater role in regulating competition within the financial services sector. This could occur by shifting ASIC's mandate for competition and consumer protection within financial services to the ACCC. This would allow the ACCC to have a central role in regulating financial services by having a core focus on consumer outcomes and competition in financial services. This would contrast with current settings where competition regulation is often in conflict with ASIC's other regulatory goals as observed above. This function would become increasingly important with increased concentration and vertical integration within the financial services sector.