CHARTERED ACCOUNTANTS
AUSTRALIA + NEW ZEALAND

Head of Secretariat
Financial System Inquiry
The Treasury
Langton Crescent
Parkes ACT 2600

By email: fsi@treasury.gov.au

26 August 2014

Dear Committee members

Financial System Inquiry – Submission on Interim report

Chartered Accountants Australia and New Zealand welcomes the opportunity to provide a submission on the interim report to the Financial System Inquiry (the Inquiry). Appendix A includes more information about Chartered Accountants Australia and New Zealand (Chartered Accountants ANZ).

Holistic approach to policy making

We consider a more holistic approach is needed to policy making. We note that there are a number of reviews and inquiries currently ongoing or due to commence, which overlap in terms of scope (refer Appendix B). It is therefore important that this Inquiry doesn't make recommendations in certain areas which are isolated from this bigger picture. For example, to achieve the policy objectives complementary changes may be needed across as multiple areas such as taxation and superannuation.

A clear retirement income system policy is needed

Australia lacks a clear long term objective or policy around our retirement income system. Achieving the right tax, legislative and regulatory settings will always be a difficult task until we are clear about what we want to achieve. An analysis of the interactions between superannuation and the aged pension system will be crucial as will the direction of tax concessions within super. It may also involve an assessment of the community's expectations of our system including access to aged pension.

Provision of Financial advisory services

While this inquiry reviews the Australian financial system and the current overarching regulatory framework a key element is to also consider issues that cannot be simply addressed by more or different regulation. A key issue is the ethical behaviour of businesses and advisers. There requires an ongoing cultural shift throughout organisations and individuals to ensure the provision of financial advice is provided based on ethical behaviour, trust ,integrity and honesty for the benefit of the Australian public.

Chartered Accountants Australia and New Zealand

33 Erskine Street, Sydney NSW 2000,
GPO Box 9985, Sydney NSW 2001, Australia
T +61 2 9290 1344 F +61 2 9262 4841

charteredaccountantsanz.com

Adviser education and training

It is widely recognised that the education and competence framework for those who provide financial advice has a range of deficiencies and the current minimum level of training must be increased. We believe there are 5 key elements and obligations required for the development a robust educational and professional standards framework for the provision of quality financial advisory services. This framework should not focus singularly on the technical education requirements. We believe the education requirements for those who provide financial advice should transition to at least an undergraduate degree level. The framework must also incorporate initial and ongoing professional education and ethical obligations that are monitored on an ongoing basis with a quality review program. The trusted relationship between a client and a professional is based on the understanding the client has of the professional's education and qualifications.

Regulators need to be agile in today's global business environment

The scope and nature of regulatory issues is constantly changing, which means that the regulators need to be fit for purpose and agile, to respond quickly to emerging issues. Regulators will need to move away from reliance on the more traditional `one size fits all' approach, and instead rely on a risk assessed basis for allocation of resources and regulatory focus. Effective regulation in today's modern cross-border business environment will also require a much greater degree of engagement and collaboration between regulators than has perhaps been the case in the past.

A flexible, incentives based retirement income system

Australia's retirement income system needs to be flexible with the ability to tailor for individual circumstances. It will be a long time before we have a mature super system in which Australians have spent their entire working lives with 12% super guarantee. Until that time, community expectations, beliefs and needs will vary greatly. We need to encourage product innovation to address these issues and provide better levels of affordable, quality advice and education for consumers. The best outcomes will be achieved by incentivising rather than mandating behaviour.

We have included our detailed comments and recommendations in the following submission.

Should you have any queries concerning the matters discussed above or wish to discuss them in further detail, please contact me via email at: lee.white@charteredaccountants.com.au; or by telephone on 02 9290 5598.

Yours sincerely

Lee White

Chief Executive Officer

Chartered Accountants Australia and New Zealand's submission to the Financial System Inquiry

We have provided comments on the following areas from the interim report:

Chapter 3 – Funding of the Australian Financial System

3.1 External administration
3.2 Retirement income products

Chapter 4 – Superannuation

4.1 Efficiency
4.2 Leverage
4.3 Stability of superannuation policy settings
4.4 Self-managed super funds

Chapter 5 – Stability

5.1 Financial claims scheme
5.2 Corporate governance

Chapter 6 – Consumer Outcomes

6.1 Disclosure
6.2 Financial advice
6.3 Independence
6.4 General advice
6.5 Adequacy of framework

Chapter 7 – Regulatory Architecture

7.1 Regulatory burden
7.2 Conduct regulation
7.3 ASIC Funding
7.4 Accountability
7.5 Council of financial regulators
7.6 ASIC's mandate

Chapter 8 – Retirement Income

8.1 System

Chapter 9 – Technology

9.1 Facilitating Innovation
9.2 Cyber Security

Taxation issues

Chapter 3 - Funding

3.1 External Administration

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

1. *No change to current arrangements.*
2. *Implement the 2012 proposals to reduce the complexity and cost of external administration for SMEs.*

The Inquiry seeks further information on the following area:

Is there evidence that Australia's external administration regime causes otherwise viable businesses to fail and, if so, what could be done to address this?

Of the two options given, we support option two, the implementation of the 2012 proposals. These proposals will help to reduce complexity and cost of external administration, subject to the amendments put forward as part of the consultation on those proposals. However the efficiency and appropriateness of the regime as it affects SMEs impacted by insolvency requires specific review over and above the 2012 proposals.

We are concerned with some of the wording within the Inquiry's draft report relating to external administration, as it appears to draw on unjustified opinion. However, the Inquiry seems to be seeking evidence relating to a concern that the current regime hinders businesses from being able to be successfully rehabilitated without occurring value destruction. On this basis, we believe that reform is required. One area for reform for example, relates to insolvent trading. There continue to be challenges for directors in adequately navigating the insolvent trading laws as presently drafted. These challenges have the potential to push directors into decisions to protect them from unnecessary exposure even though these decisions may result in value destruction. This issue was raised in the draft report under the banner of "safe harbour reforms" and is an area for further debate. Another area for reform, for example, is "ipso facto" clauses. These can cause value destruction when a company enters external administration, particularly voluntary administration, due to their impact on contract values and viability of the ongoing business.

Meaningful reform will require a reconsideration of the balance between the mechanisms to support viable, albeit potentially riskier, business ventures and the mechanisms to protect investors or creditors. Experience from overseas jurisdictions can be useful in this regard. Chartered Accountants ANZ is currently working on a joint project with the Australian Restructuring, Insolvency and Turnaround Association (ARITA) and CPA Australia to analyse international regimes and also to consider the impact of certain insolvency processes for SMEs. We support informed debate to enhancing the insolvency framework, utilising a strong governance framework of clarity, transparency and accountability.

3.2 Retirement income products

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?*

We note that the government has also recently commenced a consultation into retirement income products. We recommend the Inquiry engage with those involved in that consultation to ensure specific feedback on this area is considered by the Inquiry.

Chapter 4 – Superannuation

4.1 Efficiency

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

1. *No change to current arrangements and review the effectiveness of the MySuper regime in due course.*
2. *Consider additional mechanisms to MySuper to achieve better results for members, including auctions for default fund status.*
3. *Replace the three-day portability rule:*

> *With a longer maximum time period or a staged transfer of members' balances between funds, including expanding the regulator's power to extend the maximum time period to the entire industry in times of stress.*

> *By moving from the current prescription-based approach for portability of superannuation benefits to a principles-based approach.*

MySuper

We agree with the observations of the Inquiry that it is too early to assess whether the MySuper reforms will achieve their objective. Given the level of investment that has already been undertaken by the super industry in systems in order to comply with MySuper requirements, we believe it is appropriate to allow these measures time to prove their value. It is difficult to assess the potential benefits of further improvements, changes or enhancements without firstly assessing the impact of the initial MySuper measures.

However, we would not support a 'set and forget' approach to MySuper products. We would encourage mechanisms be put in place for a review of these products in due course to ensure they are meeting their intended objectives. Where objectives are not or are not fully met, possible changes should be explored at that time.

While discussions on MySuper are focused on the fee side, we note that the MySuper measures were not designed to simply offer a low fee fund for less engaged (or unengaged) members but to provide a simple, comparable product with certain features that are in the members' overall best interests. For this reason, we caution against too strong a focus on fees and fee reduction.

Three day portability rule

Finding the appropriate timeframe for portability of superannuation can be challenging. On one hand, individual members, prima facie should be able to expect that their super savings can be transferred to a fund of their choice in a timely fashion. During volatile economic times, fund balances can change quickly to the detriment of the member so it becomes imperative that changes to accounts, whether moving to a different fund or investment switching, be undertaken quickly.

The practicalities of this however from a funds perspective provide challenges in carrying out such requests. Issues arise in terms of being able to liquidate assets and manage cashflow. The expectations of the individual member may be unrealistic.

We believe a principles-based approach to portability is appropriate. Super funds would need to report on their portability transfers and be accountable to the regulator where unacceptable timeframes were occurring. We note that in the past, extensive delays were being experienced by some members, particularly where rollovers were requested to a self-managed super fund. Delays were often 'justified' on trivial matters and payments were not made until the last possible moment. In a number of cases, this was months after the initial request. To this end, guidance from the regulator would be warranted, setting out minimum standards expected of funds. Where unacceptable time frames were being seen, regulatory action should be taken.

We do not support a staged approach to transferring balances. This will create complexities and confusion for members. Many Australians still find difficulties arising in attempting to consolidate their superannuation accounts. Multiple transfers from multiple funds will only exacerbate this situation.

We also caution on granting the regulator powers to extend the maximum time period for the entire industry in times of stress. We believe this could operate in opposition to the members best interests. A risk-averse member invested in a cash option, for example should not be detrimentally impacted by the investment decision of the fund as a whole or by other members. Such powers to the regulator should be on a case by case basis, in which the members' best interests can be factored into the decision to grant an extension. Not all funds or investment options would require extended periods.

The Inquiry seeks further information on the following areas:

- *Does, or will, MySuper provide sufficient competitive pressures to ensure future economies of scale will be reflected in higher after-fee returns? What are the costs and benefits of auctioning the management rights to default funds principally on the basis of fees for a given asset mix? Are there alternative options?*
- *Is the recent trend of greater vertical integration in the wealth management and superannuation sectors reducing competitive pressures and contributing to higher superannuation fees? Are there mechanisms to ensure the efficiency of vertical integration flow through to consumers?*
- *Are there net benefits in tailoring asset allocation to members and/or projecting retirement incomes on superannuation statements?*
- *Is there an undue focus on short-term returns by superannuation funds? If this is a significant issue, how might it be addressed?*
- *To what extent is there a trend away from active asset management within asset classes in superannuation funds? Is this a positive or negative development for members?*
- *How could funds price switching properly and take into account differences in liquidity between asset classes?*
- *Could other arrangements be developed to facilitate asset transfers between funds when members switch? Do funds require additional mechanisms to manage liquidity beyond the need for liquidity for portability and member investment switching?*
- *Is the trust structure best placed to meet the needs of members in a cost-effective manner?*

Tailoring asset allocation

Tailoring asset allocation to individual members may prima facie be beneficial to that member. However, the provision of such services comes at a cost. The benefit of tailored asset allocation for the engaged few, may impose cost on the majority of the remaining membership. We recommend the Inquiry use caution in respect of the introduction of additional services in terms of the impact on costs which will ultimately be passed to members with increased fees.

Projecting retirement savings

The provision of simple calculations, extrapolating current contribution rates and returns to give an estimate of retirement savings at a given age would be beneficial to members as part of their annual statement. The illustration of expected savings can be a very effective means of getting people engaged in their super. Additionally, an example of the impact of additional savings (eg $10 a week) on the final resulting balance could be helpful and effective. This could work in much the same way as credit card statements which demonstrate the interest payable by paying the outstanding balance off over different time frames.

Short term returns

There is no doubt that consumers are motivated by recent returns reported by superannuation funds. Notwithstanding numerous disclosures being attached to return reports that "past returns are not indicative of future returns", consumers, where able, will look for indicators as to the current performance of funds. Moving consumers to a more long term view will need education and time. We note, however that some superannuation funds are nevertheless becoming more focused on long term performance for themselves and of the organisation's they invest in. Larger super funds, in particular are looking to infrastructure investments for long term returns. They are also seeking more transparent governance arrangements and increased focus on social and environmental issues within the organisations in which they invest.

Trust Structure

The trust model is still the most appropriate model under which superannuation funds should operate. We support the continued use of this model in which trustees act in the best interests of members. We do not believe that the trust structure imposes undue financial burden on the funds such that they be seen as cost inefficient. Fundamentally, a trust structure is desirable due to the fiduciary duties placed on trustees to look after the members' best interests. However, we note that some difficulties occur due to the differences in each state, around trust law as well as powers of attorney and stamp duty.

<u>4.2 Leverage</u>

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.

We have long supported and encouraged a review of direct borrowing by superannuation funds. Jeremy Cooper, as part of the superannuation system review, identified borrowing as a potential issue for the super sector. The panel's view at that time was that borrowing within super was not consistent with Australia's retirement income policy. However, legislation giving effect to borrowing was still relatively new at the time and as the government had further announced its intention for consumer protection mechanisms, the panel declined to make a specific recommendation other than for a review of borrowing to take place in two years time (which would have been June 2012). To date, that review has not taken place nor have the announced consumer protection mechanisms been put in place.

In the interim period, concerns from a number of regulatory sources including the ATO, ASIC and the Reserve Bank regarding undesirable trends and possible impacts of allowing borrowing within the super environment to continue, have been raised.

There is no doubt that borrowing can be a useful tool for increasing retirement savings. Conversely, it can compound and magnify losses where investments go wrong. We also note that there have been examples of individuals being inappropriately encouraged to set up an SMSF for borrowing purposes, (to invest in particular asset classes such as real estate), without a full assessment of whether an SMSF is suitable for them.

We encourage the Inquiry to recommend a comprehensive review of borrowing within superannuation. Notwithstanding that a number of funds have already engaged in these arrangements, it is not too late to re-consider policy in this area. We reject the argument that a review is not needed on the basis that borrowing is not a significant problem with the super industry, particularly with SMSFs, due to its relatively low levels of take-up. In fact, we consider this highlights the timeliness of a review to determine whether borrowing is appropriate or not before it becomes widespread, potentially impacting on funding, housing and security of retirement savings.

Should a decision be taken to ban borrowing, we consider it would need to be on a prospective basis, whereby existing borrowing arrangements are grandfathered. Borrowing arrangements are typically for large assets, which would be difficult and expensive to unwind, impacting on retirement savings.

If the review determines that borrowing can continue in super, we would then recommend a review of the regulatory and legislative framework around it. Currently, the legislation is difficult to navigate, with breaches of super law occurring too frequently. However, we note that these breaches are often due to structuring of holding trusts, paperwork, improvements to property and terminology rather than the actual use of borrowed funds to buy an asset. Further, we recommend that the regulation around those who can advise on borrowing arrangements needs to be tightened. While we do not believe that limited recourse borrowing arrangements (LRBA) should be classified as a financial product, (although specific LRBA offerings may be deemed financial products), we do consider it appropriate that anyone advising on these arrangements holds a full or limited Australian Financial Services License (AFSL) in the area of superannuation.

4.3 Stability of superannuation policy settings

We have long argued that there is too much tinkering within superannuation and against its frequent use as a budgetary tool in the annual Federal Budget. The specific changes made are often not related to efficiencies or equity in the super system but the need of the government of the day to ‘balance the books’.

Australia lacks a clear long term policy objective around our retirement income system. Achieving the right tax, legislative and regulatory settings will always be a difficult task until we are clear about what we want to achieve. An analysis of the interactions between superannuation and the aged pension system will be crucial as will the direction of tax concessions within super. It may also involve an assessment of the community’s expectations of our system including access to aged pension.

For example, if the objective of our retirement incomes system is to ensure that Australians have a comfortable retirement, than the policies need to be tailored to this objective. If higher income earners are able to adequately save for what would be, on balance, a comfortable retirement, then the tax concessions associated with this need to be re-considered, particularly during the accumulation phase. However, to the extent that compulsory contributions are still required for these people, they should be able to opt out of the compulsory super guarantee system or continue to access concessions on these amounts.

We need to be careful however that in reducing tax concessions, we don’t inadvertently prevent or hinder those who are most likely to be able to support themselves in retirement from doing so. Any targeting of high balance super funds or high income earners will need to be carefully assessed.

4.4 Self managed super funds

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?*

The growth of SMSF's in recent years has been strong. There have been a number of drivers of this growth including:

- Increased familiarity with assets and investments due to large numbers of demutualisations, privatisations and so on in recent years
- Poor returns from APRA regulated funds, particularly during the Global Financial Crisis
- Great levels of financial literacy
- Desire for greater control and flexibility
- Trends – 'the thing to have'.

Limitations placed on setup of SMSFs

SMSFs are the epitome of engagement in superannuation with people looking to take control of their retirement savings. This should be seen as a positive for the outlook of Australians retirement system. We would strongly argue against the need or desirability of placing any obstacles or limitations on those wishing to set up an SMSF.

A minimum opening balance is frequently raised as an appropriate limitation for those wishing to set up an SMSF. However, this would restrict the ability to setup an SMSF to relatively few people and generally only those who were much older with higher disposable incomes. With a minimum setup balance, it would take a significant amount of time to accumulate enough money in superannuation in order to set up an SMSF, particularly if the person is only relying on compulsory super guarantee contributions.

Such limitations could have a significant and detrimental impact on the engagement of individuals with their superannuation. It is widely accepted that the levels of engagement by most Australians with their super is insufficient – we should not therefore be introducing measures to exacerbate this situation. We also believe that restricting access may impact on an individual's overall financial situation which again may impact on their ability to achieve a comfortable retirement.

High operating expenses of many SMSFs

Setting up an SMSF is a conscious, pro-active decision by those wanting to take control of their superannuation savings. SMSF trustees will typically have good line of sight over the expenditures incurred by the fund and make decisions accordingly. . The operating expenses of an SMSF trustee are largely within their control for their own benefit/detriment. Should expenses become too high, SMSF members are able to go back to a larger APRA regulated fund should they wish. We note also that while there are low balance funds with greater relative operating expenses, many SMSFs have highly competitive fee levels compared to APRA regulated funds. We do not consider that operating expenses in SMSFs should be an area of concern for the Inquiry

Tax concessions in SMSFs compared to APRA funds

We agree with observations made by the Inquiry regarding the placement of tax concessions in SMSFs compared to APRA regulated funds. Tax laws relating to superannuation funds are the same, regardless of whether the fund is an SMSF or an APRA regulated fund. The significant difference between the two types of funds is that SMSFs are able to manage the tax environment far more efficiently than their larger counterparts, particularly around timing of transactions, sale of assets and capital gains. This has always been a desirable feature of SMSFs in terms of controlling the fund's investments and operations for the members best interest and to maximise opportunities of improved retirement savings.

While we are supportive of the Inquiry rejecting arguments of SMSFs having tax advantages that APRA funds do not, we also caution against inferring that those setting up an SMSF should not be motivated by tax outcomes. Tax concessions underpin the framework of our superannuation system and SMSFs should not be singled out as taking unfair advantage.

Chapter 5 – Stability

5.1 Financial claims scheme

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

1. *No change to current arrangements.*
2. *Modify the FCS, possibly including simplification, lowering the insured threshold or introducing an ex ante fee.*

The Inquiry seeks further information on the following areas:

> *What measures could be taken to simplify the FCS with minimal burden on industry, while still ensuring the effectiveness of the scheme?*

> *What is an appropriate threshold for the FCS guarantee of deposits?*

The financial claims scheme is having an impact on investment decisions. The scheme enables individuals to invest large sums across a number of financial institutions in risk free deposits. It negatively impacts other institutions not covered by the scheme but offering similar longer term products, such as annuities. Those institutions covered by the scheme have greater access to risk free funding at lower costs via increased customer deposits than other institutions, which impacts competition in the market.

We support option two, a lowering of the insured threshold. We do not support the introduction of an ex-ante fee for all insured deposits. However, an ex-ante fee could be introduced on balances in excess of a certain amount if there are strong calls to retain a higher insured threshold and the costs of implementing such a model are reasonable. For example, balances up to $50,000 could be insured with no fee and an ex-ante fee imposed on balances between $50,000 and $250,000.

5.2 Corporate Governance

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

1. *No change to current arrangements.*
2. *Review prudential requirements on boards to ensure they do not draw boards into operational matters.*
3. *Regulators continue to clarify their expectations on the role of boards.*

The Inquiry seeks further information on the following area:

Is it appropriate for directors in different parts of the financial system to have different duties? For example, differences between the duties of directors of banks and insurers and trustees of superannuation funds. Who should directors' primary duty be to?

Part 2D.1 of the *Corporations Act 2001* clearly sets out the duties and powers of directors. This includes the obligation that directors must exercise their powers and discharge their duties in good faith in the best interests of the corporation. While there are other requirements around directors and their duties, we do not believe there should be any change to directors' primary duty as set out in the Corporations Act.

However, it is important to recognise the broadening of duties beyond the corporation and shareholders and the role of other stakeholders to the organisation. We do not support different parts of the financial system having different duties. The Corporations Act and the ASX Corporate Governance Principles and Recommendations are designed to be applied to all corporations.

Chapter 6 – consumer outcomes

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

1. *No change to current arrangements.*
2. *Improve the current disclosure requirements using mechanisms to enhance consumer understanding, including layered disclosure, risk profile disclosure and online comparators.*
3. *Remove disclosure requirements that have proven ineffective and facilitate new ways of providing information to consumers, including using technology and electronic delivery.*
4. *Subject product issuers to a range of product design requirements, such as targeted regulation of product features and distribution requirements to promote provision of suitable products to consumers.*
5. *Provide ASIC with additional powers such as:*

> *Product intervention powers to prescribe marketing terminology for complex or more risky products.*

> *A power to temporarily ban products where there is significant likelihood of detriment to consumers.*

6. *Consider a move towards more default products with simple features and fee structures.*

The Inquiry seeks further information on the following areas:

> *Do similar issues in relation to the PDS disclosure regime apply to prospectuses, and is there a need to review prospectus requirements?*

> *What evidence is there on the effectiveness of financial literacy strategies in enhancing consumer confidence and decision making at particular points in time, and in achieving increasing literacy over the long term?*

6.1 Disclosure

We agree with the view presented in Chapter 6-3-55, "Post-GFC Regulatory Response – Consumer Outcomes: Current disclosure obligations": that in general the current complex, lengthy and often costly disclosure requirements do not enable consumer understanding of financial products and services.

Overall, we support second proposed option, improvements to the current disclosure requirements using the high-level solutions that have been proposed. These include layered disclosure, the use of technology, risk profile disclosure and improving consumers' access to information by using online tools and comparators. We acknowledge that the proposals in the report are intentionally high level due to its interim nature. We encourage the Inquiry to consider the following points prior to formulating their more detailed recommendations.

Layered Disclosure

Under the proposed layered disclosure approach, consumers will initially receive a clear, concise summary of the key financial information they need to make informed investment decisions. More detailed and comprehensive financial information, such as full financial statements, will be made available elsewhere, most likely online. We are support this approach; however we encourage the Inquiry to be mindful of the need to encourage consumers to refer to full financial statements *prior* to making investment decisions.

To this end, we encourage the inclusion of appropriately placed and firmly worded warnings and disclaimers alongside the summary key financial information. Such warnings would advise consumers against making investment decisions without first referring to the full financial statements and seeking appropriate advice from a suitably qualified professional. We envisage that a hyperlink to the full financial statements will be included with digitally based summary financial information, making them easy for consumers to access.

Further, the separation of key product information from the summary financial information creates a risk that consumers will read and consider only the information contained in the summary financial information, overlooking relevant and material information located elsewhere.

We support the proposed layered disclosure approach in cases where it does not create an information gap for consumers.

Summary financial information

We envisage that there would be a requirement for summary financial information to be compiled in accordance with International Financial Reporting Standards (IFRS).[1] We acknowledge that there will be instances in which non-IFRS financial information be relevant. In November 2011 ASIC published Regulatory Guide 230: *Disclosing Non-IFRS Financial Information*. We note that Section D Table 2 and paragraph RG 230.62, recommend that reconciliations from non-IFRS to IFRS financial information should be clearly labelled, and that they should be provided at least once in each document in which non-IFRS financial information is disclosed.

We recommend that in cases where non-IFRS financial information is contained within the proposed summary financial information document, the accompanying reconciliation to information prepared in accordance with IFRS should also be located within this document, and that the non-IFRS financial information should be clearly labelled as such.

Financial literacy

Whilst we cannot provide the Inquiry with specific evidence, we do consider that financial literacy has a place to play in improving consumer confidence and decision making. It should be noted that while there is benefit in improving consumers' financial literacy the resulting benefit will not occur in the short term, it will be almost a generational change. There has been some calls and statements in regards to "buyer beware" and the need for consumers to take a greater responsibility. But until this generational change occurs in financial literacy the greater and ongoing responsibility lies with both the product manufacturers and those that provide financial advisory services.

[1] We note that Australian Accounting Standards are based on IFRS.

6.2 Financial advice

The Australian financial services industry (and the financial system more broadly) has a generally strong and robust framework however in this post GFC period, there are indications of deficiencies and inadequacies that require review and consideration. The services associated with the provision of financial advice and the delivery of quality advice is significant for many Australians.

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

> *No change to current requirements*
> *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*

The financial services industry continues to grow in complexity, this includes the products, services and in areas such as taxation and social security. As a consequence, the need for technical professionals providing advice to Australians is critical. The financial planning industry widely accepts that there are deficiencies in the current education framework for financial planners. Technical expertise, the level of education and consistency are vital to the overall financial advisory services regulatory framework.

The development of consumers' trust in financial planners and the financial planning industry will be enhanced by the introduction of a consistent level of education. Currently the education requirements introduced through Financial Services Reform are at a minimum level and the training courses available range from a few days to completion of a post graduate diploma or under graduate degree. All of these course options meet the regulatory requirement of a financial planner becoming compliant with ASIC Regulatory Guide 146. Unfortunately a further deficiency is that there is a lack of consistency and quality between these various training courses. Australians cannot have a professional relationship with an adviser when there is such disparity in the education levels of the advisers in the industry. The trusted relationship between a client and other professionals such as doctors, lawyers, and accountants is based on the understanding the client has of that professions' education and qualifications.

Education is an important component, however, it is not a stand-alone solution to improving the services and advice provided by financial planners. Specifically, enhanced education regulation will not eliminate the problems that have arisen from the various corporate collapses over the last five years. Education is wider than the technical and theoretical component of the education process.

In a paper the Institute of Chartered Accountants Australia released in 2007 it was noted - "Higher academic standards must be accompanied by compulsory training of all new entrants in a solid ethical framework". Interestingly as previously mentioned despite the education requirements that exist currently and the regulations that are in place, ethical behaviour is not an area that can be regulated. Ethics is a behavioural attribute that must be developed from the outset for all financial advisers and on an ongoing basis.

In addition it is recommended that an experience or practical component be included for all new financial advisers. While the technical and theoretical components of providing financial advisory services can be developed through traditional education programs, the provision of financial advice requires a practical experience component.

For example, the Chartered Accountants Program incorporates a practical experience program. The purpose of the practical experience requirement is for candidates of the Chartered Accountants Program to build on their academic qualifications by applying theoretical knowledge and developing the professional skills and values relevant to their specific job.

The workplace provides the professional environment for candidates of the Chartered Accountants Program to develop and apply their professional knowledge and skills. It is also in the workplace where they will face real professional issues.

It is important to emphasise that these critical technical and practical components for delivering a professional advisory service to consumers cannot be achieved through a short form course.

We have had a long held view that the education requirements for those who provide financial advice be transitioned to at least an undergraduate degree level. We also would encourage program to include a practical experience component.

Educational and Professional Standards Framework

We believe there are 5 key elements and obligations required for the development a robust educational and professional standards framework for the provision of quality financial advisory services. This framework should not focus singularly on the technical education requirements. The framework must incorporate initial and ongoing professional education and ethical obligations that are monitored on an ongoing basis with a quality review program.

The framework should include the following:

1. Initial qualifications and training at an undergraduate degree level (Australian Qualifications Framework Level 7)
2. Professional education program
   Incorporating both technical education and a mentor program of 3 years practical experience (monitoring and supervision)
3. Professional Membership (Certificate of Public Practice)
   Promote, review and enforce the standards of behaviour and performance of members.
4. Ongoing Continuing Professional Education
   All professionals must identify, develop, maintain and improve upon their knowledge and skills. It is vital professionals maintain their professional knowledge and skill at a level required to ensure that their clients receive the advantages of competent professional services based on the latest developments in practice, law and business.
5. Ongoing Quality Review
   A quality review program ensures that those providing financial advisory services maintain a consistently high standard of quality and service to clients. It is a key feature of a co-regulatory framework, together with high entry standards, training and development requirements, and comprehensive professional standards.

National Examination for financial advisers

ASIC has previously consulted on the training of financial advisers and the professional development framework for financial advisers. In addition currently the Government, through an Industry Working Group, has commenced reviewing the education standards and professional standards for financial planners. One component considered by ASIC in their consultations to address the competency of financial advisers was the introduction of a national exam. While there may be some merit in having a national exam (and it is used in some countries), it will not in itself address the issues to broadly increase the competence of financial advisers. The approach to improve the competence and education of financial advisers must be from an overarching holistic perspective that incorporates not only the technical expertise but the skills needed by financial advisers. This entails not only ensuring the training and qualifications are at an appropriate level and cover all the technical areas but that also the training industry and training providers are appropriately regulated. In addition this approach should incorporate a robust professional standards framework that encompasses the behavioural traits of a professional.

Public register of financial advisers

Currently there is not a register of all the individuals who provide financial advice. The development of a public register of financial advisers is an important element of enhancing transparency for consumers and assisting ASIC with its oversight of the financial advice industry. This is a priority issue for the Government with it being currently addressed through an Industry Working Group.

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?*

It is widely accepted that there is value for consumers in receiving quality financial advice and that the importance of advice will increase significantly as consumers build greater wealth through their superannuation.

The propositions ASIC has put forward as to the reasons consumers are not seeking advice include financial literacy, perceptions that advice is out of reach, lack of trust in financial advisers, not wanting comprehensive advice and cost. All of these are valid issues from a consumer perspective. It is vital not to address these issues individually as they are not stand alone but rather all interrelated. All of these issues must be addressed to close the gap. (However if there is greater "trust", this will flow through to the other perceptions of advice.) In addition, as with many of the issues to be addressed, enhancing consumer access to advice is a long term policy objective and will not be resolved by short term fixes.

Currently financial literacy impacts all of these issues in terms of perceptions over trust, need, access and cost. As previously stated cost or price relates to perceived value, similarly a perception that advice must be comprehensive or is out of reach is due to a general lack of understanding of the opportunities.

In the short term, one of the key opportunities available is to increase the number of providers of financial advice and have consumers leverage this. One of the objectives of the Future of Financial Advice reforms was to increase the access to financial advice and this was to be partly addressed through the removal of the "accountants' exemption" from 1 July 2016 and the introduction of the new licensing regime professional accountants will be required to operate under.

One of the key elements of this new framework is to have professional accountants provide a form of *non-product* strategic advice. A significant number of Australians use a tax agent and the predominant advisers to small businesses are professional accountants. There also exists a level of trust around the services and advice professional accountants provide. As a consequence there is an enormous opportunity to provide this type of advice for consumers. To ensure this opportunity is taken advantage of, it is critical that the pathway for professional accountants is efficient to ensure as many as possible professional accountants move into this new advice framework.

6.3 Independence

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?*

Whilst there is significant debate about the pros and cons between independent and aligned advisers, both operate under valid business models and can provide a valuable service offering to consumers as long as the consumer understands the differences. From a consumer perspective, there are two elements to consider. Firstly, assuming the current framework continues many consumers will not be able to clearly understand the differences and what that entails. Secondly, while this is the case consumers will value characteristics of an adviser differently. Some will want an independent adviser and others will find value in an adviser aligned for example with a financial institution. Based on this it is vital that there is appropriate transparency and disclosure of how advisers operate.

As a consequence there is an ongoing need to provide education for consumers; however one must be mindful that the results of any education will be long term. Currently there is an industry working group looking into the development of a register of financial advisers, there is no doubt that this will, in due course, assist consumers in obtaining a better understanding of the "ownership" and aligned adviser issue. However there is still a need to appropriately educate consumers on the differences and what that means to them.

Cost and price are always a consideration when a consumer is making a decision over the purchase of a product or service. Again consumers will vary in terms of their sensitivity to price. The key element is "value". Consumers' concerns over price directly relate to their understanding of the value they are receiving. In recent years many advisers, like the industry generally, have moved away from a predominantly "commission based" remuneration structure to one where the remuneration is paid directly from client rather than the product manufacturer. This has required advisers to reassess their "value proposition". From a consumer perspective, part of the perceived value they will consider is the value of independence.

6.4 General advice

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

1. *No change to current arrangements*
2. *Rename general advice as 'sales' or 'product information' and mandate that the term 'advice' can only be used in relation to personal advice.*

While guidance has been provided, for example by ASIC, clearly the issue and understanding of "general advice" has been misunderstood at various levels. Even within the industry "general advice" appears to be a grey area with a range of opinions of what can and cannot be provided under "general advice". However most importantly how do consumers perceive "general" versus "personal" advice. Irrespective of the explanation and disclosure consumers receive, there will be misunderstandings.

From a consumer perspective, we support option two as we consider there would be value in renaming the term "general" advice to "sale" or "product information". This would clearly inform consumers as to the service they are receiving.

Chapter 7 – regulatory architecture

7.1 Regulatory burden

The Inquiry seeks further information on the following areas:

> *Is there evidence to support conclusions that the regulatory burden is relatively high in Australia when considered against comparable jurisdictions?*

> *Are there examples where it can be demonstrated that the costs of regulation affecting the financial system are outweighing the benefits?*

> *Are there examples where a more tailored approach could be taken to regulation; for example, for smaller ADIs?*

> *Are there regulatory outcomes that could be improved, without adding to the complexity or volume of existing rules?*

> *Could data collection processes be streamlined?*

> *If new data is required, is there existing data reporting that could be dropped?*

> *Instead of collecting new data, could more be made of existing data, including making more of it publicly available?*

Overall, we consider an appropriate balance is needed between providing the safety and soundness required by consumers and business with the level of regulation. The financial system is closely inter-related and linked, which means a change in regulation in one place could have unintended consequences in a number of other areas. Efficiencies can be achieved through the automation of data collection processes, for example through Standard Business Reporting. The sharing of data amongst regulators and government agencies would also reduce the duplication of reporting.

As noted in our submission on the Inquiry's terms of reference, substantial tax data collection obligations are imposed on the financial services industry, and it is expected that this burden will increase as part of moves by the United States and the OECD to obtain data on cross-border financial transactions. The Inquiry should consider ways in which this burden can be alleviated.

7.2 Conduct regulation

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.*

We support the recommendations from the super system review that additional regulation of SMSF accountants and administrators is not warranted. The panel believed that the accounting professional bodies are best placed to achieve increased competencies without further regulation, through provision of guidance to their members.

Since the time of the review, the accounting bodies have made significant contributions to achieving this objective through provision of training events including major SMSF conferences, publications, manuals, tools, checklists and formal guidance. Chartered Accountants ANZ also introduced for its members the ability to be recognised and endorsed as a CA SMSF specialist. The criteria for CA SMSF specialisation includes a mandatory education and assessment requirement (many other specialist offerings do not require this) as well as minimum experience levels in SMSFs..

7.3 ASIC Funding

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.*

Both ASIC and APRA do not have a high degree of independence in terms of their budget. Their budget allocations are set annually and, for in ASIC in particular, are quite variable from year-to-year. ASIC and APRA are under-funded and changes to their funding models should be considered. While industry funding models may appear attractive in times of fiscal restraint for governments, there are a number of issues which need to be fully considered. This includes how a user pays system can be applied equitably across the regulated community as opposed to a simple perceived ability to pay.

7.4 Accountability

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

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

The current funding system for Commonwealth government agencies to be subject to an efficiency dividend each year is a blunt instrument. We would support enhancing the role of both Statements of Expectation and Statements of Intent. Changes to these statements, which ensure accountability and transparency of the regulators, should be encouraged. The New Zealand model does provide some lessons which could be applied in Australia.

The oversight process of regulators is fragmented. We would support option six, a clearer and more straightforward oversight mechanism that is transparent and ensures the accountability of the regulators. We recommend the Auditor-General be responsible for reviewing and holding the regulators accountable for following and meeting their statements of expectations. We also consider that the Statements of Expectations should be set by Parliament, rather than the regulators themselves.

7.5 Council of Financial regulators

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

1. *No change to current arrangements.*
2. *Consider increasing the role, transparency and external accountability mechanisms of the CFR:*

> *Formalise the role of the CFR within statute.*

> *Increase the CFR membership to include the ACCC, AUSTRAC and the ATO.*

> *Increase the reporting by the CFR.*

We support changes to the current arrangements such as increasing the membership, however we don’t consider there is a need to formalise the role of the CFR within statute or increase reporting as this would deter from the main objective, which is frank discussion.

7.6 ASIC’s mandate

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

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

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?*

In today’s global business environment it is vital for all of Australia’s regulators, including ASIC, to be able to respond in a timely manner to changes in the business and economic landscape. The scope and nature of regulatory issues is constantly changing, which means that the regulatory bodies need to be fit for purpose and ready to adapt, and respond to, emerging issues before they become more significant with widespread implications. By necessity, the dynamic nature of business activities in today’s economy will require regulators in Australia and around the world to move away from reliance on the more traditional `one size fits all’ approach, and instead rely on a risk assessed basis for allocation of resources and regulatory focus.

Although ASIC, along with Australia’s other law enforcement agencies and regulators, would appear to have a clearly defined mandate, the interaction and working relationship between key regulatory agencies does not always present itself as cohesive (to external stakeholders). In recent years there have been a number of cases where regulatory agencies are seen to lay responsibility for poor regulatory outcomes at the feet of other agencies, rather than being seen to cooperate as one cohesive group of law enforcements agencies. Effective regulation in today’s modern cross-border business environment will require a much greater degree of engagement and collaboration between regulators than has perhaps been the case in the past.

Chapter 8 - Retirement Income

8.1 System

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:

1. *Maintain the status quo with improved provision of financial advice and removal of impediments to product development.*
2. *Provide policy incentives to encourage retirees to purchase retirement income products that help manage longevity and other risks.*
3. *Introduce a default option for how individuals take their retirement benefits.*
4. *Mandate the use of particular retirement income products (in full or in part, or for later stages of retirement).*

Improved financial advice and removal of impediments to product development

Regardless of any other policy decisions, the provision of quality, affordable, accessible financial advice is paramount to the success of our retirement income system. This includes information and tailored advice from finance professionals as well as easy access to widely available information, tools and education. Improving the financial literacy of all Australians continues to be a challenge for government and the broader community. The desire of Australians to seek financial advice is intrinsically linked to the confidence they have in the system as a whole and the source of advice and information. Confidence leads to engagement and this is what is ultimately needed to ensure the financial wellbeing of all Australians.

We strongly encourage the removal of impediments to product development, wherever possible. We also recommend consideration of incentives to encourage product development. This will be important to enable innovators the scope to address specific risk issues and problems of increasing longevity in the system. Furthermore, we believe greater choices and flexibility of products will foster confidence and engagement in the broader retirement income system.

Policy incentives to purchase retirement products or mandates for particular products

Community expectations, beliefs and traditions will greatly impact on the decisions individuals make for their retirement. Individuals often desire to leave some monies to their beneficiaries. Their fear of ‘losing out’ to the insurance companies if they purchase an annuity product but don’t reach their life expectancy and the fear of running out of money should they live a long time, will drive the decisions they make in retirement.

Australia still has a long way to go to achieve a mature superannuation system whereby people will have experienced a full 12% super guarantee for their entire working lives. Therefore, low balances on retirement will feature for some time to come. Lump sum withdrawals will therefore continue to be attractive to those with mortgages and where income streams would be negligible.

To modify these behaviours and attitudes, incentives to change will play an important role. As the Inquiry rightly observes, it is difficult to come up with settings that will suit everyone. Individual circumstances will vary significantly and as a whole, we are better off with a system that allows tailoring and flexibility for individual circumstances. Therefore, we strongly encourage consideration of the use of incentives rather than mandates for driving behavioural changes around selection of retirement products. Mandating a specific product could ultimately have a negative impact on individuals, particularly where we do not have a mature system.

Default option

While default options can be desirable in certain areas, for example choice of fund or investment options during the accumulation phase, it may not be quite so desirable when it comes to withdrawals from the super system. We identify the following areas for consideration:

- Perceptions that ‘default’ options may actually be mandatory
- Difficulties in defining what a default option is, given the differing features of retirement income products
- When would a default option commence? The need to access super monies can vary greatly from person to person and is not necessarily a factor of age or retirement
- A default option may be detrimental to an individual’s personal financial situation, including their ability to access aged pension.
- Money withdrawn from the system is very difficult to get back into the system, post retirement
- May have the same effect as mandatory cashing of benefits (no longer required or desired)

Chapter 9 – Technology

9.1 Facilitating Innovation

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

- *Establish a central mechanism or body for monitoring and advising Government on technology and innovation. Consider, for example, a public–private sector collaborative body or changing the mandate of an existing body to include technology and innovation.*
- *Establish a whole-of-Government technology strategy to enable innovation.*
- *The Inquiry seeks further information on the following areas:*
- *Are there specific areas in which Government or regulators need to facilitate innovation through regulation or coordinated action? For example, by facilitating the development of central utilities?*
- *Are there ways to improve how regulators monitor or address emerging technological developments? For example, through adopting new technologies or mechanisms for industry intelligence gathering*

The Senate referred an inquiry into Australia’s innovation system to the Senate Economics Reference Committee on 18 March 2014. The Committee is considering a number of submissions before reporting on its findings. We believe the Inquiry should not pre-empt the findings of the Committee.

9.2 Cyber Security

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

1. *Review and update the 2009 Cyber Security Strategy to reflect changes in the threat environment, improve cohesion in policy implementation and progress public– private sector collaboration.*

The Inquiry seeks further information on the following areas:

> *Would a private–public sector discussion forum for strategic issues, such as cyber crisis planning, improve cohesion in implementing cyber security policy? What other mechanisms might assist to improve cohesion or coordination?*

> *Is there a need for more cross-sectoral or transnational mechanisms for information sharing, or for Government to work with industry to initiate the development of a collaborative model similar to the United States FS-ISAC?*

> *How useful would a voluntary cyber security framework, similar to that of the United States NIST, be in assisting industry to develop cyber capabilities?*

Australia's Cyber Security Strategy is relatively old, having been set in 2009. This is an area which is constantly changing with new threats being uncovered at a rapid pace. We believe the strategy should be updated as a matter of priority. It is vital that the updated strategy is achieved through a coordinated approach between government and the private sector.

Taxation issues forming part of the broader tax reform framework

The Interim Report identifies several important tax topics relevant to the Panel's work, including negative gearing, the capital gains tax discount and the dividend imputation system. These tax issues are closely interrelated with key aspects of the Inquiry such as superannuation and retirement benefits. The broader policy objectives in these areas require consideration of taxation policy in an integrated fashion and not as a separate component. There are many stakeholders within the business community and civil society with a keen interest in these topics, and they have perspectives which go beyond the financial system.

As noted in the Interim Report, the Government will soon embark upon a tax reform process in which these and many more aspects of the Australian tax system will be discussed. Chartered Accountants Australia and New Zealand will contribute to the tax reform consultative process. We believe that particular features of the current tax system (such as those identified by the Panel) should not be addressed in isolation from the broader tax policy framework necessary to build a sustainable tax base for Australia.

At a practical level, trade-offs (e.g. between direct and indirect tax policies) may also be required in finalizing the White Paper on Tax Reform.

Finally, the proposed Federalism White Paper will no doubt address Federal-State tax arrangements in a bid to reduce inefficient taxes which hamper our financial system. We will also contribute to this project.

For these reasons, Chartered Accountants Australia and New Zealand will reserve its position on tax-related issues identified in the Interim Report and await the commencement of the broader tax reform process.

Appendix A

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is made up of over 100,000 diverse, talented and financially astute professionals who utilise their skills every day to make a difference for businesses the world over.

Members of Chartered Accountants Australia and New Zealand and are known for professional integrity, principled judgement and financial discipline, and a forward-looking approach to business.

We focus on the education and lifelong learning of members, and engage in advocacy and thought leadership in areas that impact the economy and domestic and international capital markets.

We are members of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

Chartered Accountants Australia and New Zealand is a trading name for the Institute of Chartered Accountants in Australia (ABN 50 084 642 571) and the New Zealand Institute of Chartered Accountants – see charteredaccountantsanz.com for further information.