

IFSA/Deloitte Future Leaders Luncheon 30 October 2009



Investment & Financial Services Association Ltd

Keynote address: John Brogden, IFSA CEO

"The first 100 days"

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JOHN BROGDEN: Well thank you very much Mr Chairman, I appreciate the opportunity to speak at IFSA today. And it is very significant for me to see so many of you here, I appreciate the large turnout.

Ladies and gentlemen the members of the Investment & Financial Services Association, Australia's leading wealth managers exist to achieve three outcomes for Australians; to increase their wealth, to protect their lives and to provide them with a comfortable retirement.

Today I want to address where our industry has been in recent years and the need to ensure that Australia does not miss the opportunity to increase superannuation savings as the economy returns to full health.

The funds management industry is one of the great successes of the Australian economy. Since compulsory superannuation was introduced in 1992, funds under management have grown from \$250 billion to over \$1.3 trillion, greater than the size of the Australian economy.

Of this \$1.3 trillion, approximately half can be attributed to compulsory superannuation, with the balance divided between voluntary contributions and managed investments. Australia is now the fourth largest pool of managed funds in the world and the largest in our region. Collective investment vehicles account for one-third of the value of the Australian Stock Exchange.

The investment and financial services industry is crucial to our economy, not just as a facilitator of investment, but as a creator of economic employment, growth - economic and employment growth in its own right.

In 2008/2009 the finance and insurance industries combined, accounted for 8.1 per cent of the total economy. The financial services and insurance industry directly employs some 400,000 people, many in high skilled, high wage occupations. Indirectly, through the businesses we invest in, we employ millions more.

The size of the industry means that we have a responsibility, not just to our individual members to get it right, we also have a responsibility to the Australian economy as a whole.

Funds management is not a protected industry. It does not hide behind tariff barriers. We're not a 'rust belt' industry. Rather, we trade off our competitive advantage in having a highly educated and highly skilled workforce. Two recent international studies highlight the strength of the Australian funds management industry.

The results of the 2009 World Economic Forum Financial Development Report, released this month, demonstrated the resilience of the Australian economy and financial system. Australia was ranked the number two financial centre in the world, up from number eight last year. Significantly Australia was ranked first for financial market access.

The second study, the Melbourne Mercer Global Pension Index, ranked Australia in a comparison of 11 retirement income systems from around the world. The comparisons included the Netherlands, Sweden, Canada, UK, US, Chile, Singapore, Germany, China and Japan.

However an important finding, within that report, was the need for more certainty and confidence in the system. The report noted that the role of the private sector is becoming increasingly important in many countries as Governments transfer responsibility for the provision of retirement incomes to individuals.

Therefore, confidence in the private sector system is critical and the perception of legislative risk or continually fiddling with the rules must be avoided.

The report found that the Australian retirement income system ranks second to the Netherlands for integrity and second to Sweden for sustainability. However, in terms of adequacy, Australia was fourth behind the Netherlands, Canada and Sweden.

Ladies and gentlemen we have come out of the global financial crisis well and we are particularly well placed to take advantage of a growing market. Global funds management represents a significant potential export growth market for Australia.

There are a number of factors which are expected to drive growth in investment globally. Ageing populations in mature and developing economies, coupled with pension system reforms and liberalisation and growing wealth in developed and developing countries combined with pressure to fund commitments to defined benefit and corporate pension schemes. The shift away from banking deposit products to wealth management products which are drivers of productive capital is another, along with the growth and diversification of sovereign wealth funds.

Australia has an extraordinary opportunity to become a major exporter of financial services. Research developed by Lateral Economics has shown that lifting finance and insurance exports, as a share of Australia's GDP, from the current 2.9 per cent say to five per cent, would deliver an eventual \$3.7 billion stimulus to the Australian economy and lift the export share to 10 per cent.

Modelling by Access Economics in 2008 indicated that increasing the financial services sector share of exports from the current 3.1 per cent to 10 per cent by 2010 would have the following results; \$3.3 billion additional export income, an increase in GDP of 0.3 per cent or \$19 billion and up to an additional 25,000 new jobs in our economy.

The resources boom presented a great opportunity for Australia to increase our superannuation savings. In the four years to September 2008 Australia's terms of trade rose over 50 per cent

and exports grew by over 80 per cent. Australia experienced, as we all know, the longest period of sustained growth since World War II.

During this period, through the publication of the intergenerational report in 2002 and 2005, the budgetary and economic issues arising from our ageing population were fully revealed. This placed the issue of adequate superannuation front of mind for the Australian Government.

There were significant improvements to the superannuation system during this period. Choice of super fund increased competition and empowered Australians to take control of their superannuation. The exemption from tax on end benefits for Australians aged over 60 in 2007 significantly increased the incentive for individuals to invest in their own retirement income and the co-contribution scheme for low income earners.

However the second intergenerational report showed that the areas where there was still insignificant progress were the cost of aged care and aged pensions.

The confluence of a strong economy on the back of the resources boom and the growing challenge of our ageing population should have been the impetus in superannuation. But the big opportunity of the decade was missed, and this is a big but. The introduction of the superannuation guarantee in 1992, phasing in employer contributions to nine per cent, was the first step on the path to adequate retirement incomes.

The Hawke-Keating Government's vision for superannuation went to the next step, raising compulsory contributions to 15 per cent.

The Howard Government failed to complete this policy. More than a decade of economic growth provided the opportunity not just for tax cuts, but for a combination of tax cuts and increases in the Superannuation Guarantee.

Increasing the Superannuation Guarantee is never easy, but it is so much easier during the boom years. As a result, the issue of population ageing and a lack of adequate retirement incomes

remains, as Peter Costello called it, our demographic date with destiny.

The number of people aged between 65 and 84 is expected to more than double in the next 40 years, and the number of people aged over 85 is expected to increase by four and a half times.

We believe the best way to alleviate the fiscal pressure of an ageing population, on the age pension, pillar one, is to enhance and accelerate both mandatory super - the mandatory Superannuation Guarantee, pillar two, and the voluntary contribution, pillar three, to retirement.

As the economy recovers, Australia has the opportunity yet again to lead the world in retirement income policy, by raising the Superannuation Guarantee from nine per cent to 12 per cent.

I appreciate that employers will be concerned by this change, and we recognise that it cannot be done overnight. IFSA's position is that the increase should be phased in over 10 years from 2010. It's possible for the Government to return increased tax revenue to taxpayers partly as tax cuts and partly as an increase in superannuation payments.

Now, we're all aware that the Secretary of Treasury, Ken Henry, is presently undertaking a significant review of the tax system. In his interim report he stated that nine per cent is adequate. Well, I say that adequate is not enough. Nine per cent will not provide the retirement that many expect, and I welcome the Minister for Financial Services, Chris Bowen's entry into the debate earlier this month, when he said that Australia needed to discuss whether to aim for something more than adequate. Rest assured, Australians do not want their retirement incomes to be merely adequate. And adequate just won't cut it.

Chris Bowen also recently stated that there was a need for tax changes to increase the savings of low and middle income earners. He said "Tax concessions for low and middle income earners to save through Super are less than those for high income earners".

The fact that the top five per cent of contributors make around a quarter of all concessional contributions to superannuation, while 1.2 millions Australians do not receive an income tax benefit on their concessional contributions, is a compelling one.

We agree that tax concessions need to be improved for low income earners. However, this should not be done at the expense of higher income earners. It is true that there is presently no tax incentive for lower income earners to put more into superannuation. But just as this is inequitable, it would be unfair to penalise middle and higher income earners from becoming self-funded retirees.

Ladies and gentlemen, arising out of the recent financial crisis, the liquidity and capital requirements of companies around the world has come into focus. IFSA strongly believes that the current capital requirements for superannuation funds are ludicrous.

Confidence of superannuation fund members and safety of their retirement savings are fundamental to securing and protecting our superannuation system.

Let me underscore why I firmly believe this is the case. The minimum capital requirement for a superannuation fund was set in 1993, at \$5 million. This is unacceptable for a savings pool that is now over \$1.3 trillion.

Superannuation capital requirements should address operational, regulatory, credit, and strategic risks. IFSA has called, also, for new liquidity and pricing standards for superannuation funds. Appropriate levels of liquidity are required to allow funds to meet obligations to members to pay benefits on time, and facilitate portability under fund choice. And they're required to enable investment, which is to occur without distorting strategic asset allocation of the fund.

The requirements under the SIS must be amended to align payment, portability, and asset valuation requirements. Super fund members bear a significant amount of investment risk. However, institutional and operational risks are carried by trustees.

Funds can be severely stress tested, as was recently seen, when market cycles are on a downward turn. Consequently, IFSA recommends that illiquid funds or investment options be defined as those holding 20 per cent or more in illiquid assets. Illiquid assets should be valued every 12 months, and illiquid funds should be required to align their redemption and valuation process to preserve equity and guard against arbitrage. The difference between liquid and illiquid funds needs to be clearly communicated to consumers.

Ladies and gentlemen, another challenge for our industry is effectively communicating the value of financial advice. I want to take this opportunity to state that our industry has not done enough to communicate the benefits of financial advice to consumers. This, if you like, is our mea culpa on behalf of the industry. We have allowed the debate over the value of financial advice to be superseded by the debate over the cost of financial advice.

This has allowed critics to diminish the vital role that financial advice plays in securing the personal and financial wellbeing of Australians. So, let us now take a step in the right direction. We believe strongly that good financial advice adds tremendous value to the financial welfare of individuals and their families in good and bad economic times.

At the heart of financial advice is its ability to help individuals and their families adopt a savings regime to allow them to reach their financial and retirement goals. Financial advice is also critically important to ensuring Australians have appropriate levels of insurance cover to safeguard their family's quality of life in the event of an accident, sickness, or death.

Today I'm foreshadowing a report that underscores the importance of financial advice. Research by KPMG Econtech shows that those who receive financial advice save over \$2400 more per annum than those who do not receive advice. Using the data, KPMG Econtech then undertook economy wide modelling to estimate the impact of financial advice on the Australian macro economy.

The additional saving by individuals receiving financial advice lifts household savings and hence national savings levels. The model

showed this; if an extra five per cent of Australians receive financial advice, the implications for the Australian economy would be substantial. Savings as a proportion of GDP would be half a per cent higher by 2014-15.

Foreign liabilities would be approximately 1.5 per cent of GDP less. The lower reliance on foreign investment could lower the risk premium for investment in Australia, so that gains in business capital are sustained over the longer term. And GDP would be 0.6 per cent higher by 2014-15.

This will be delivered through gains in business capital and employment. This highlights the value of advice not just for individuals who save more as a result, but also for Australia as a whole, by reducing foreign borrowing requirements.

Given the clear value and importance of financial advice, any reforms to advice resulting from the current reviews undertaken by the Government must ensure affordable access to financial advice for those Australians who most need it, particularly low income earners and young people.

Maximising access to financial advice is integral to increasing retirement incomes for working Australians.

This research reinforces the need for there to be equitable access to financial advice for all Australians. To this end, we repeat our call to improve access to financial advice by making all financial planning fees tax deductible. As we've said before, if it's suitable and appropriate for tax advice to be tax deductible, it is just as suitable and appropriate for financial advice in its totality to qualify for tax deductibility.

Indeed, millions of Australians who need financial advice don't get it now because of the cost. IFSA believes that increasing access to affordable advice is critical. Failure to do so would be a disservice to millions of Australians who could gain significant financial and wellbeing benefits from the receipt of quality financial advice.

As a strong advocate of financial advice, we are also strong advocates for high standards for financial advisers. It is in the

interests of the financial services sector to have bad planners weeded out.

The collapse of Storm is an important reminder that just as good advice improves the quality of life, bad advice can wreak havoc.

We are unashamed advocates of quality financial advice. IFSA strongly advocates improving entry level requirements, ongoing qualifications, and professional development for financial planners.

These reforms must ensure affordable access to financial advice for those who most need it.

As an industry, we have recognised that we should strive to continuously improve the financial services regime to ensure it remains responsive to change. To this end, in June this year IFSA announced a super member charter that will, among other initiatives, aim directly to benefit consumers. It will bind our members to move to a transparent fee-based model for financial advice, starting from 1 July 2010.

The charter has three commitments to super fund members: informed choice, fairness, and competition. It contains recommendations to lift the bar both in public policy and in industry practice.

While some recommendations are for the Government and for regulators to address, one very important set of reforms is for the industry to deliver.

Commencing in July 2010 we plan a fresh approach to the payment for financial advice on superannuation. This will boost confidence in superannuation at a time when it is most needed. Under the new regime, consumers will be empowered by knowing exactly how much they are paying for financial advice on their superannuation. Fund members will be able to negotiate the advice fees they pay, and to opt in or opt out of advice payments depending on their circumstances and needs. IFSA's member companies are already implementing these principles.

Just this week AMP told fund managers that their products must not include commissions if they want to be on the approved product list for its 1600 financial planners.

Other vital measures contained in the charter include making performance reporting on industry-wide standards so consumers can, for the first time, really compare apples with apples. We are also seeking consistent regulation of all super products along with stronger measures to prevent misleading advertising and promotional practices. These initiatives will help ensure open, fair and transparent competition in superannuation.

Ladies and gentlemen, as an industry we need to re-state that competition is the driver of efficiency, effectiveness and innovation in financial services. The sheer weight of money in super, ever improving transparency regarding the options available to Australians, and the fact that Australians are exercising choice, has supported competition within the industry.

To date, this competition has been effective in putting downward pressure on superannuation fees. Since 2002, Rice Warner Actuaries have published the superannuation fees report. Their June 2008 report showed that superannuation fees averaged 1.21 per cent as a percentage of assets under management, compared to 1.26 in 2006, and 1.37 in 2002.

The results of competition are also apparent with the average fee charged by a large corporate retail master trust, falling by 36 per cent since 2002 - from 124 basis points to 79 basis points, making this the lowest cost segment of the industry.

It is important that competition be allowed to take place in the default fund market as well, to ensure the benefits of competition are maximised.

It is clear that fees have reduced and this trend will continue as the pool of funds grows and competition grows with it.

Finally, in my early days in this role, I have been stunned by the level of division within the superannuation industry over current and future policy settings. Consumer confidence in the industry as a whole is crucial to our success. When one segment of the

industry attacks another, consumer confidence in the whole industry suffers. Doubt is seeded and subsequent commentary can be ill-informed. Nobody wins from the Balkanisation of the message of the superannuation industry in Australia.

So if we're to overcome the challenges facing the industry and to provide the retirement incomes that Australians expect, the superannuation industry as a whole needs to work together on policy.

Ladies and gentlemen, when compared against the rest of the world, our industry has done well through the financial crisis. This is something we should and can be proud of, both as an industry and as a nation. However, we can do much more to take advantage of the opportunities that are being presented to us presently.

The Government reviews underway are a challenge for our industry but they are also a significant opportunity. They are an opportunity for us to influence the way our industry is structured for growth. And our biggest challenge amongst that, and the biggest challenge for IFSA and its members, is to ensure that working Australians will have adequate retirement incomes and the financial wellbeing they both expect and deserve.

Thank you.

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