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Dear Sir/Madam

### **Financial System Inquiry Final Report**

CPA Australia represents the diverse interests of more than 150,000 members in 120 countries, including more than 25,000 members working in senior leadership positions. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Against this background we provide this submission in response to the Final Report of the Financial System Inquiry.

CPA Australia is supportive of the Inquiry, and is in broad agreement with the direction of its findings and many of its recommendations. However, we do have some specific concerns and points of clarification in regards to the following areas:

- Superannuation and retirement incomes
- Consumer outcomes
- Regulatory System
- Innovation

Detailed comments are included in the attachment to this letter.

If you have any questions regarding this submission, please do not hesitate to contact Mr Michael Davison, Senior Policy Adviser – Superannuation on 02 6267 8552 or [michael.davison@cpaaustralia.com.au](mailto:michael.davison@cpaaustralia.com.au) or Mrs Keddie Waller, Policy Adviser - Financial Planning on 03 9606 9816 or [keddie.waller@cpaaustralia.com.au](mailto:keddie.waller@cpaaustralia.com.au).

Yours faithfully

A handwritten signature in black ink, appearing to read "Paul Drum".

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# **CPA Australia's response to the Financial System Inquiry Final Report**

## **Superannuation and retirement incomes**

### **Direct borrowing by superannuation funds**

CPA Australia does not support the Inquiry's recommendation to restore the general prohibition on direct borrowing by superannuation.

We acknowledge the Inquiry's concerns regarding the possible impact of leveraging on the systemic risk of the superannuation system. However, we believe these concerns are premature and influenced by the recent media attention focussed on the increase of SMSFs borrowing to invest in property.

At the moment, the number of super funds and the percentage of assets invested through leveraged arrangements is still relatively small, albeit growing. Further, leveraging is a legitimate investment tool and can form an important part of a long-term investment strategy.

It is however important that trustees only enter into these arrangements in accordance with, and as part of, a properly formulated and prudent investment strategy. It is the trustee's responsibility to consider the appropriateness of these arrangements when developing their investment strategy, taking into account risk, return, liquidity needs, cash flow and the needs of all members within the fund.

We would also like to clarify the limited recourse nature of the permitted borrowings. In the discussion on page 87 of the final report, references are made to trustees being likely to sell other assets of their superannuation fund to repay lenders if the value of a leveraged asset falls significantly. Given the law limits the lender's recourse to the asset itself and a fund's exposure to the asset is limited to the value of its holding in the asset, this is not possible.

The potential risk with the current growth in leveraging arrangements is not in the leveraging itself. Rather, it is a result of investors receiving poor or no advice before entering into such arrangements. Our primary concern is the provision of inappropriate advice and the potential misinformation being provided by unlicensed advisers such as real estate agents, mortgage brokers and property developers.

Only after the immediate problem of inappropriate advice is addressed can the true impact of leveraging on the superannuation system be considered.

### **Objectives of the superannuation system**

CPA Australia supports the Inquiry's recommendation that the Government should seek broad agreement on the objectives of the superannuation system. However, we believe developing an effective retirement savings policy is more than just developing objectives for the superannuation system, it must also encompass the age pension, non-superannuation investments, including the family home, and age care.

A long-term vision for Australia's retirement savings system must articulate a clear purpose and goals, for example poverty alleviation or maintenance of living standards, and how these goals can be achieved.

The primary objectives of Australia's retirement savings system should be threefold:

1. To provide assistance and incentives for individuals to save sufficiently and effectively in order to maintain a reasonable standard of living throughout their whole life cycle, i.e. to provide mechanisms to smooth income and hence consumption through both their working life and retirement.
2. Where individuals have not had the means to save sufficiently, the system should provide adequate support to alleviate poverty.
3. To provide insurance to protect retirees from certain risks, such as mortality, morbidity, longevity, investment, inflation and system failure.

An ideal retirement savings system should also display three primary characteristics:

- Simple – the system should be simple in design, implementation and operation. For the average person to be able to accept and engage with their super, they need to be able to understand it.
- Sufficient – to provide an adequate level of retirement savings to maintain a reasonable standard of living in retirement.
- Sustainable – not only in the sense of being able to maintain government support and expenditure for future generations but to also be robust to withstand external shocks – such as the global financial crisis – and maintain equity to ensure continued support and engagement of the system thus minimising the risk of future system change.

CPA Australia believes the current structure of Australia's retirement savings system – that is, the three pillars: the aged pension, compulsory superannuation and voluntary superannuation savings – is appropriate to meet our retirement savings goals. However, the challenge is to ensure that the right mix is maintained that provides adequate retirement savings for individuals while ensuring the system is simple, efficient and equitable.

In developing a long-term retirement savings policy, consideration must be given to the following factors:

- **What is the retirement savings goal?** – Is it poverty alleviation or the maintenance of income levels and standards of living in retirement? Should it look beyond providing a stream of income and provide a range of resources in retirement, including an income stream, to also finance age, nursing and health care?
- **Should there be an adequacy target?** – How much do we need or should we be aiming for in retirement?
- **What is the role of the age pension?** – The first pillar has always been considered a 'safety net' for those individuals who have not had the means to save sufficiently for themselves. However, there has been a very real shift, and acceptance, so that the age pension is supplementing the compulsory system (or vice versa) to the point where some 70 per cent of retirees are receiving at least part of the age pension. This is understandable at the moment as current retirees have not had the benefit of a mature super guarantee (SG) system. However, as the SG system matures this dependency needs to be wound back so that by the time the system has fully matured, around 2035, the age pension is only being provided as a safety net for those members of society in genuine need.

- **What is the purpose of superannuation?** - Is it, as recommended by the Financial Systems Inquiry, to provide income in retirement to substitute or supplement the age pension? Or are there other ancillary purposes, such as housing or education costs, that should be considered and will future superannuation savings be sufficient to allow secondary purposes? It is likely opening superannuation up to ancillary purposes would require higher contribution levels.
- **Are lump-sum benefits an appropriate default?** CPA Australia research showed that many Australians are using superannuation to extinguish household debt rather than fund retirement<sup>1</sup>. Should retirement income streams be encouraged over lump-sums or be compulsory?
- **Coverage of superannuation** – Compulsory superannuation is essentially linked to employment. Should it be extended to the self-employed and people out of the workforce (parents, students, unemployed, carers, etc.) and if so, how?
- **Compulsory superannuation** – Should we have compulsory superannuation? What is the appropriate level and mix between compulsory and voluntary savings? Should people be able to opt-out of compulsory super if they have sufficient savings or to avoid penalty due to particular thresholds, such as the current contribution caps?
- **What is the appropriate encouragement for retirement savings?** – Is there an appropriate level of compulsion to support retirement savings and retirement income streams? Or what incentives should be provided as encouragement and as compensation for locking money away in superannuation?
- **Taxation of superannuation** – One incentive for locking money away in the superannuation system is the concessional tax treatment. However, the current tax concessions are heavily skewed towards high income earners, with low income earners getting little, if any benefit. The removal of end benefits tax from age 60 may have been appropriate in the short term as current and imminent retirees have not had access to a mature SG system. However, as the system matures it may be appropriate to rethink this position in the long term and consider shifting some of the tax burden from the contributions phase to the benefits phase, albeit with a long transition phase.

Is the use of tax concessions an appropriate policy lever to encourage particular retirement savings behavior? For example, should there be taxation thresholds to discourage lump-sums over a certain level or concessional tax treatment to encourage retirement income streams?

- **Level of government support** – There has been considerable discussion about the current level of tax concessions provided to superannuation. However, the debate has largely ignored the cost to future governments of providing income support, i.e. the age pension, to future retirees and how increased superannuation savings would reduce this. The discussion must shift to one on the level of total government support over both an individual's working life and in retirement. Only then can we discuss what is an appropriate and fair level of government support.

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<sup>1</sup> Household savings and retirement: Where has all my super gone? (October 2012)  
<http://www.cpaaustralia.com.au/~media/corporate/allfiles/document/professional-resources/superannuation/household-savings-retirement.pdf>

- **Accessibility to benefits** – What is the appropriate age pension age and preservation age for superannuation?

The age pension age of 65 was set at the turn of last century when average life expectancy was 55. Average life expectancy is now over age 80 and increasing so it makes sense to increase age pension age as has already happened with the increase to age 67 from 1 July 2023. However, should it be lifted further as life expectancies increase or should it be linked to life expectancies so it automatically increases as life expectancies increase?

As the age pension age increases, should the superannuation preservation age also increase to minimise early access to superannuation to minimise the risk of retirement savings being exhausted before age pension age?

What are the appropriate forms of early access to superannuation benefits for individuals prior to age pension age, for example, permanent disability, terminal illness or forced early retirement?

- **Workforce participation and transition to retirement** – The 2015 Intergenerational Report shows that in 2055 there will only be 2.7 people aged 15 to 64 for each person aged 65 or older, down from 4.5 in 2015, and workforce participation will decline as the population ages. Consideration must be given to incentives to encourage people to work past age pension age and/or defer commencement of the age pension and to defer drawing down of superannuation savings. Similarly, incentives need to be considered to aid individuals to transition into retirement and to provide flexibility to move into and out of retirement as needed.
- **Non-superannuation savings** – non-superannuation savings, particularly the family home, should be considered part of the retirement savings equation. Consideration must be given to unlocking the wealth in the family home to provide income in retirement. This could be through providing support for downsizing, reverse mortgages or using sale proceeds to purchase longevity insurance products such as deferred income streams.

Given the substantial wealth locked up in the family home, consideration should also be given to including the family home in assessing age pension eligibility, possibly by including it in the assets test above certain thresholds.

- **Age care and health care costs** – need to be considered when determining income requirements and levels of government support in retirement.

Setting clear objectives would also permit us to measure the performance of the retirement savings system against those objectives.

As a starting point in the discussion, CPA Australia believes the development of Australia's retirement savings policy should consider the following points:

- Maintaining the 'three pillars' structure but increase the simplicity of the system to increase the efficiency of the system.
- Superannuation savings should be a substitute for the age pension
- As the SG system matures, the first pillar – the age pension – needs to shift back from supplementing the compulsory system to being a genuine safety net.

- Target government assistance at low and middle income earners to encourage retirement savings.
- Assistance needs to be provided to individuals on the fringe of the compulsory system, such as people out of the workforce.
- Compulsory superannuation should be extended to the self-employed.
- There should be limits to the level of lifetime government support.
- The tax burden on superannuation should shift from the contributions phase to the benefits phase.
- The age pension age should be increased in line with life expectancy increases. The preservation age and threshold for tax free superannuation benefits should be aligned with the age pension age less five years.
- Appropriate incentives need to be provided to encourage a retirement income stream culture.

Ideally, the most equitable retirement savings system would tax income in the hand of the individual when it is actually received.

A long lead time for change is also needed to minimise any disadvantage for the current generation who haven't had SG all their working life, have only had low age-based deduction limits, haven't had the government co-contributions in their younger working years, and have been subject to the contribution surcharge. Too many changes too soon may see this age group becoming a disadvantaged group as they were either too young or too old to gain any advantage from recent positive reform but have experienced many of the negative measures.

### **Removing retirement savings from the political cycle**

Importantly, it is imperative that superannuation and retirement savings policy are removed from the political cycle through bipartisan support of our long-term retirement savings goals. We believe there is merit in the establishment of an independent body to oversee retirement savings policy, as proposed by the previous government, and further consideration should be given to this.

As an example, New Zealand's Commission for Financial Literacy and Retirement Income conduct independent research, three-yearly reviews of New Zealand's retirement incomes policy, promote financial literacy and advise the New Zealand government on policy directions. We also understand The National Association of Pensions Funds in the UK has called for the establishment of an Independent Retirement Savings Commission to take on a similar role as we have proposed.

### **Improving efficiency during accumulation**

CPA Australia has previously suggested that ideally superannuation should be removed from modern awards and at a minimum any MySuper product should be eligible for nomination as a default fund provided it meets a broad range of selection criteria, including:

- the appropriateness of the investment strategy
- long-term net performance against fund benchmarks

- level of fees
- availability, suitability and cost of insurance, and
- other services provided to members.

We are not opposed to the introduction of a formal competitive process to allocate default members to MySuper products as it is an extension of what we proposed previously. However, we are concerned by the undue focus on fees in the Inquiry's final report. A focus of fees alone may well result in a 'race to the bottom' where investment returns and members' interests are compromised to provide the best price.

The focus should be on the overall value provided to fund members and maximising retirement outcomes. Any competitive process should consider the criteria listed above.

We would support a Productivity Commission inquiry into the removal of superannuation from modern awards and the benefits of the introduction of a competitive process for the selection of default superannuation funds.

### **The retirement phase of superannuation**

CPA Australia agrees with the Inquiry's previous observations that the retirement phase of superannuation is underdeveloped. We believe we need to move away from superannuation being seen purely as a savings vehicle and need to start considering it as a lifelong retirement incomes vehicle. We need to encourage the transition to a retirement incomes culture where the focus is on income in retirement not a lump-sum at retirement.

As such we support the Inquiry's recommendations for trustees to pre-select a comprehensive income product for retirement (CIPR), essentially a default retirement income stream, for their members.

However, greater emphasis is needed on the fact that this would most likely be a default suite of products – an immediate income product, a longevity product and access to a lump sum – not a single product as suggested by the CIPR descriptor.

It must also be recognised that many superannuation funds will not be in a position to develop their own retirement income products, particularly pooled longevity products such as deferred lifetime annuities (DLAs) or group self-annuitisation (GSA) schemes, and will have to look to collaborations with other superannuation funds or to external providers. As such, the more pressing priority is the removal of the regulatory impediments to product development, as also recommended by the Inquiry, to encourage product innovation. In particular, the requirements to pay an amount of income each year and limitations on the variation of payments each year essentially prevent the development of many DLAs and GSA schemes.

We support a more flexible, principles based approach to the income stream rules. For example, but not limited to, allowing for:

- the deferral of annual payments during the deferral period of a deferred income stream
- exemption from minimum annual payment requirements during deferral period

- variations in annual payments when the income stream is supported by a collective pooling arrangement
- fixed term income streams being paid past age 100 (considering expected increases in life expectancy)
- the payment of a death benefit in the early years of an income stream, and
- protection for impaired lives.

The overarching principle would be that income streams are for providing a regular income in retirement with some flexibility for periods of deferral but the return of capital cannot be deferred indefinitely.

A primary focus on removing the regulatory impediments to product innovation would also encourage the development of products that may also benefit members of self-managed superannuation funds. While SMSF trustees should not have to develop CIPRs for themselves, nor would it be practical to do so, they still need to have the same access to flexible retirement income solutions as members of APRA regulated funds. This should either be through being able to access DLAs and GSA schemes through a SMSF or being able to easily transfer to these products without penalty.

We also disagree with the Inquiry's assertion that policy incentives should not be used to encourage the use of retirement income products and the encouragement provided by the CIPR default would be sufficient. We disagree with this and believe incentives will still be required to encourage people to keep their retirement savings in a CIPR, contribute to their superannuation in the first place, and, importantly, to compensate them for locking their savings away in deferred or pooled products.

To provide encouragement for the take up and retention of retirement income products more flexibility is needed with the recognition given to deferred income streams in the income and assets tests for the age pension so that they are exempt during the deferral period and non-commutable income streams remain exempt from the assets test during the payment period.

Consideration should also be given to policy levers to discourage the taking of lump sum benefits such as capping the amount that can be taken as a lump sum or capping the amount that can be taken tax free after age 60. We would expect this to be considered as part of the White Paper on the Reform of Australia's Tax System.

The other impediment to the purchase of longevity risk products, such as deferred annuities, is that they do not receive the same tax exempt treatment on income from their supporting assets during the deferral period that immediate income streams receive. If the purchase price was treated similarly to an insurance premium instead of an investment product, with no tax on the earnings of the supporting assets during the deferral period, they would be considerably more attractive.

If impediments to longevity products were removed, issuers of these products would still face challenges in sourcing long-dated investments to back them. Consideration should be given to funding for such products and, in particular, increasing the maximum tenor of Commonwealth bonds and taking further steps to encourage greater development of the domestic corporate bond market.



To further encourage the transition from a savings vehicle to a retirement income vehicle we also support the publishing of retirement income projections on members statements as recommended by the Inquiry (Recommendation 37).

### **Governance of superannuation funds**

CPA Australia supports the intent of the Inquiry's recommendations to improve the governance of superannuation funds. However, we do not support the mandating of independent directors, either a majority or otherwise.

We believe there has been undue focus on independent trustees in the recent discussions of superannuation fund governance when there is no evidence of shortcomings in this area or evidence of a compelling benefit to superannuation fund members. Director independence is only one aspect of good governance and in itself will not necessarily drive good governance outcomes.

Given the unique characteristics of the superannuation industry and its participants we do not believe an overly prescriptive approach is appropriate. Instead we suggest a different approach in which an overarching governance framework is described addressing the characteristics of the industry and its participants, from which threshold principles of good governance could be articulated. This should provide a more sound basis for the operationalisation of good governance within corporate trustee entities. This focus on independent directors presents some risk of distracting attention away from critical attributes of fiduciary duty and beneficiary interest which are essential to superannuation.

An overarching governance framework should adopt a principal focus on duties, from which other elements of a framework would stem. These other elements would then span issues such as disclosure and board structure. It would be far more preferable to look at the essence of the objectives of superannuation entities and how this determines relationships, objectives and duties. Such a framework would:

- Distinguish between common law duties (in the specific context here, predominately one of fiduciary relationship) and statutory duties, identifying their sources and where there is overlap or interaction. This would assist a director to navigate through a complexity of rules and moreover, understand the purpose of the rules.
- Provide a concise categorisation and discussion of the fiduciary rules – conflict, profit, and misappropriation.
- Define the boundaries between fiduciary based duties and other duties, such as care and diligence.
- Describe the division of powers, addressing where powers of management reside and what are the limits on such powers.
- Discuss who it is that owes the duties, considering ancillary issues of delegation and reliance.
- Describe to whom the duties are owed – again reinforcing the objective and fundamental nature of superannuation structures themselves. This would also enable some description of member rights and how they are pursued.
- Identify who it is that enforces duties – thus addressing some elements of the enforcement framework, including some discussion of consequences of breach of duty.

## **Consumer outcomes**

The majority of financial planners provide quality advice that consumers can have confidence in and positively impacts a consumer's financial wellbeing. However, as stated in the final report the current framework needs to more effectively align the governance and corporate culture of financial firms, employees and other representatives.

There is also a strong need to better align commercial incentives with consumer outcomes. Under the current framework, there is often a conflict between the objective to maximise the distribution of financial products and the financial needs of the consumer. Recent examples of poor conduct and advice have often been a direct result of this conflict, where the consumer has been recommended a strategy and in turn a financial product that was not suitable for their circumstances.

Improving levels of consumer financial literacy will enable consumers to make more informed decisions about their finances. However, there is also a need to lift the education and professional standards for financial planners to ensure consumers consistently receive quality financial advice that they can be confident is in their best interests.

## **Raise the competency of advisers and align the interests of financial advisers and consumers**

Given the responsibility and obligations a financial adviser has to their clients, for some time, CPA Australia has expressed our significant concerns regarding the adequacy of current minimum training standards. Indeed, it is our view that the current requirements put at risk the financial future of many Australians who inadvertently rely, in good faith, on advice which is inadequate or is not appropriately tailored to their individual circumstance.

The Financial Systems Inquiry and other initiatives represent a unique opportunity to implement real and much needed change which will deliver long term positive outcomes for both the financial advice sector and consumers who seek financial advice.

There are no short term measures that will address the current deficiencies and immediately rebuild trust in this sector. Further, it cannot be a superficial piecemeal approach. Instead it must be a coherent and all encompassing framework that addresses the necessary elements required to provide quality financial advice.

We believe central to this reform is a new robust education and professional framework that raises the bar on financial advice and ensure better quality advice that is consistently in the best interests of the consumer. The framework should include the following core elements:

### **1. Lift the current minimum education level for individuals providing Tier 1 advice from AQF 5 – Diploma to AQF 7 – Bachelor Degree.**

Setting a minimum education level will provide multiple pathways into the industry, as an individual could complete a range of qualifications to meet the education standards. This would include Bachelor degree, Bachelor Honours Degree, Graduate Certificate, Graduate Diploma or Masters.

### **2. A new holistic curriculum is developed which clearly articulates the knowledge and skills to provide holistic personal Tier 1 advice to clients, with specific learning outcomes and set quantum of study for each core area identified.**

This would ensure that irrespective of the qualification that an individual completed, the individual would have been assessed against the same curriculum and required the individual to demonstrate the same set learning outcomes.

**3. The framework must mandate a mix of rigorous and independent assessment forms which require an individual to demonstrate the achievement of the set learning outcomes for each core area.**

An individual must demonstrate their knowledge and skills in the relevant course or components by some means of independent and objective assessment. Such assessment should be rigorous and have integrity.

**4. The new education framework must prescribe a minimum level of continuous professional development (CPD) over a three-year period, including minimum levels of CPD that must be achieved each year.**

This ensures a consistent threshold in the sector that will drive a commitment to maintain, update and deepen a financial planner's knowledge and skills.

**5. A statutory code of conduct that applies to all individuals under the AFS licensing regime should be implemented to foster an ethical culture and increase professionalism.**

Improving the education and training standards will aid in improving the quality of financial advice. However, it will not effectively address issues around conduct and behaviour. One of the key objectives for the financial advice sector should be to positively influence behavioural change to promote consumer confidence and trust in the advice they receive. This is something that requires a long-term focus; it cannot be addressed with any short-term solution.

The financial advice industry is already highly regulated. It is this complex array of legislative requirements that is currently contributing to the ever rising cost of advice, which is having a significant impact on the access of advice for many consumers. Further, it is resulting in ongoing consolidation in the advice industry where many independent licensees are finding they can no longer sustain the high cost of compliance.

The financial services industry is structured differently to other sectors and professions. With most professions, usually it is the individual who is required to register or become licensed to practice. In the AFS licensing regime, it is more common for an entity to apply for the AFS licence and for the individual to become authorised under this licence. As such, there is delineation between responsibilities on the licensee and the individual.

There is also significant variation in how a financial adviser may operate. A financial adviser may independently hold their own AFS licence. Alternatively they may operate under another AFS licence as a direct employee or within their own practice. A financial adviser may or may not also be a member of an industry association or a professional body.

As a consequence, the most efficient and far-reaching mechanism which could be readily developed and implemented to enhance consumer confidence and trust, is a statutory code of conduct. This code would apply to all individuals under the AFS licensing regime.

Such a code should be built on the core principles of:

- honesty and integrity
- independence

- competence; and
- confidentiality.

It also aligns with other segments of the advice industry, such as tax where the Tax Practitioners Board is responsible for the oversight and enforcement of a statutory Code of Professional Conduct.

The many benefits of one statutory code of conduct that is principles-based include that it:

- will effectively foster an ethical culture and increase professionalism
- can apply to all individuals under the AFS licensing regime, regardless of the advice or service they provide
- clearly sets out a consistent and uniform framework of expected behaviour that will act as an umbrella to existing legislative obligations, without adding another heavy layer of compliance
- requires all advice and services are provided to consumers in accordance with appropriate standards of professional and ethical conduct
- Does not require the approval of multiple codes, which can lead to inefficiencies and inconsistencies in application and therefore has limited ability to achieve a consistent professional framework; and
- can apply to all individuals, regardless of whether they are a member of a professional or industry body.

Most importantly it will improve consumer confidence in the sector, as there will be a clear assurance that all financial advisers will be required to comply with the same code that will be enforced and interpreted consistently.

**6. All new financial advisers should be mentored for a 12 month period by an appropriate supervisor, to embed the skills of providing quality advice and the attributes of the code of conduct early in a financial adviser's career, resulting in a better experience for the consumer.**

This will develop a financial planner's skills and embed at the beginning of a person's career the attributes of a code of professional conduct and culture. It is also an opportunity to help a new adviser further develop their knowledge and skills to provide quality advice and importantly how to build a trusting and valuable relationship with the client.

This new framework is vital to rebuild the confidence and trust in financial advice that has been so demonstrably eroded by recent scandals, with a view to replicating the trusted relationship that generally exists between a client and other professionals such as doctors, lawyers, and professional accountants.

While in comparison, the financial advice sector is relatively young. It is these core elements that are absent from the existing financial advice regime, yet would drive real change.

As financial services become more complex so do the many financial decisions consumers have to make about their financial position. Receiving valuable financial advice will become more significant for consumers and it is therefore vital that they have confidence and trust in the advice they receive.

The new Financial Advisers Register (FAR) will also play an important role in building confidence by delivering a new level of transparency. However, we believe critical to the success of the register was that an appropriate amount of time was taken to ensure it is designed in a manner that will be consumer-friendly and provide valuable information that is presented in a meaningful and clear manner. We are concerned that the process is being unnecessarily rushed and that this may risk the quality and usefulness of the enhanced register, thus compromising its primary policy objective.

### **Product intervention power**

CPA Australia support in principle providing ASIC additional powers to allow for more timely and targeted intervention and in turn reduce the risk of significant detriment to consumers. Should ASIC be granted these powers, we agree that it should set out in a practice statement how it intends to use the new powers. While we believe that ASIC has no intention to misuse such powers, in order to generate confidence in the new system ASIC must set out how it will interpret the law and how it will implement them.

However, ASIC has stated more than once that a lack of resources inhibits its ability to investigate issues such as corrupt advisers. Senate and parliamentary inquiries have also raised concerns that the regulator has not been proactive or transparent in its actions. Given this, we question whether granting ASIC with such powers will result in reducing the risk of significant detriment to consumers.

Granting ASIC such powers could also create a form of moral hazard. Consumers may believe if ASIC has a proactive product intervention power, that as a result there are no poor or underperforming products in the market. Therefore if ASIC are given this new power it is important that the power is reviewed after a period to ensure it is in fact achieving its stated objective.

## Regulatory system

### Definition of 'general advice' and 'personal advice'

The term 'general advice' could imply that the advice has been in some way tailored for the client. However, general advice captures more than just promotional and sales information highlighting the potential benefits of a financial product. It also captures economic updates or broad advice about an asset class.

Therefore while we support the need to review the current definition, we believe consideration should be given to implementing a tiered definition such as:

- general information – e.g. economic updates or asset class information
- product information – e.g. information about a specific product that does not consider one or more of the client's circumstances.

Importantly, any proposed term/s should be adequately tested with consumers to help reduce consumer misinterpretation and excessive reliance on this type of information.

The report from the Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry* also recommended that 'personal advice' be redefined and amended to 'financial advice'. This recommendation has been supported by some industry stakeholders.

CPA Australia do not support this amendment as the term financial advice is itself generic and would in fact capture a wide range of advice beyond financial product advice. It also fails to convey that the advice has been tailored or personalised in some manner specifically for the client.

The real benefit of financial advice is the advice itself. It is important that we have a regulatory system that allows for this to happen, otherwise the advice provided is constrained and will not deliver the best result for the advisor's clients.

One way to address this would be to separate the 'advice' and any 'product' recommendation. This will result in advisers being able to provide non-product strategic advice in a more efficient and effective manner to clients, delivering confidence and transparency to this sector.

### Wholesale and retail clients

The global financial crisis highlighted the need to review the current objective and subjective tests used to determine if an investor should be classed as a wholesale client. It also highlighted the fact that high levels of personal wealth are not always a true reflection of a person's financial literacy, evidenced by instances where some investors were unaware they had been classed as a wholesale client.

In 2011, an options paper was released which explored the appropriateness of the current tests and relevant thresholds. However, this was never progressed and some four years later the need to implement change has become even more critical. These changes are necessary to ensure adequate investor protection, given the increase in personal wealth since 1991 through factors such as the increase in the average wage over that period, higher incidence of compulsory superannuation and higher property values.

## **Innovation**

Embedding an innovative culture throughout Australian businesses is critical if Australia is to raise productivity, improve international competitiveness and create the high paying jobs of the future.

Like most developed economies Australia is simultaneously grappling with various complex and often interdependent challenges including the rise of the digital economy, the reconfiguration of global supply chains, the demise of traditional manufacturing, the volatile impact of climate change and the rapid uptake of new technologies in virtually every sector of the economy.

If Australia is to successfully confront these challenges and reap the substantial benefits that will inevitably arise from the new digital and knowledge based economy, it is essential that the Government implement a holistic suite of policies to encourage a culture of creativity and entrepreneurship.

Such policies need to be robust, comprehensible and stable so that the private sector has more certainty in investing in new technologies, new industries and new skill sets.

In realising this goal it is imperative that we do not simply regard innovation as an offshoot of industry policy, but rather as a mindset which informs all major facets of Government policy, including the Government's response to the final report of the Financial System Inquiry.

### **Improving the regulatory framework to better adapt to and support technological innovation**

Innovation in technology has the potential to significantly change the financial sector's competitive landscape for the benefit of consumers and business, particularly small business. However, for Australia to realise this potential, we must improve the financial system's regulatory framework so that it can adapt to new technology and other innovations with greater speed and encourage the development of new technologies and innovations in Australia. Recent experiences with the slow policy response to the emergence of crowd-sourced equity funding show that our current regulatory system needs to be more agile.

### **Reducing the regulatory burden on small technology businesses posing a smaller risk to the financial system**

The greater use of graduated regulatory responses to emerging issues would also encourage greater technological innovation. This would involve imposing lower-intensity regulation on small technology companies that pose a smaller risk to the financial system. An example of such a graduated approach is the policy options the government is considering in response to crowd-sourced equity funding.

## **Establishing a formal consultation process between regulators, financial sector participants and technology businesses**

We support the establishing of a formal collaboration process between regulators, financial sector participants and innovative technology businesses. Such formal collaboration would assist in identifying opportunities for innovation and technological development and emerging issues. This would enable more timely and coordinated policy and regulatory responses to such developments.

## **Crowd-sourced equity funding**

CPA Australia strongly supports legislative change to encourage greater access to crowd-sourced equity funding by a significantly wider range of Australian businesses, particularly small start-up businesses. Such a regime must however strike an appropriate balance between the financing needs of business and investor protections.

Of the two reform models being considered by the government, we favour the New Zealand model with some variations to align the model with the Australian financial services licensing regime and to reduce the risks of conflicts of interest. We believe the New Zealand model with such adjustments strikes the best balance between the funding needs of innovative businesses, investor protection for what will be highly speculative investments and better encouraging the development of a liquid secondary market.

## **Greater business access to data held by the government**

A matter of significant importance to the future competitiveness and innovation of Australian business, including the financial sector and potential new entrants to the financial sector is improved public access to government data, otherwise known as 'open data'.

As we stated in our submission to the Inquiry, there are issues with the utility of disclosing aggregated taxation data, particularly as such data is prepared to meet a taxation obligation, which does not necessarily mean that such data is usable for other purposes. Commercially available private-sector data may be of greater use to potential financial system participants, however the proprietary nature of such information may make it difficult for alternative business models to emerge using that private data.

Given this issue requires more consideration, we support the recommendation in the final report that the Government task the Productivity Commission with holding an inquiry into the costs and benefits of increasing access to and improving the use of public and private sector data.



## **Other**

### **Corporate administration and insolvency**

We support the recommendation in the final report that the Government consult on possible amendments to the external administration regime to consider whether it is necessary to provide additional flexibility for businesses in financial difficulty. We note that the Productivity Commission, through its inquiry into business set-up, transfer and closure is currently considering Australia's personal and corporate insolvency regimes and suggest that the Government consider this recommendation as part of its response to the final report of this Productivity Commission inquiry.

### **Taxation**

We note that the final report suggests a number of taxation issues be considered as part of the White Paper process. We agree with that approach, however we believe that some specific tax reform priorities relevant to the financial sector and beyond need to be considered by the Government in the 2015-16 Budget. These priorities are detailed below:

#### ***R&D tax incentive***

In our view the only significant change required to the R&D tax incentive is to increase access to the 45 per cent refundable tax offset to help fund the R&D activities of a broader range of SME companies as we believe that the growth of new industries is most likely to emerge in this sector.

The availability of this refundable tax offset is critical so that SME companies have access to the vital cash flow necessary to fund risky and complex R&D during the initial phases of operations.

We therefore recommend that access to the refundable 45 per cent tax offset should be extended by lifting the eligibility threshold for SME companies from the current threshold limit of \$20 million aggregated annual turnover to a \$50 million aggregated annual turnover threshold.

#### ***Revising the tax rules associated with early stage venture capital limited partnerships***

To remedy the limitation associated with the accessing the early stage venture capital limited partnership regime, we strongly believe that the government should revise the tax rules to expand the circumstances in which the income and capital gains tax exemptions available under such structures can be accessed by the venture capital market.

We therefore recommend that the eligibility criteria for accessing early stage venture capital limited partnerships be broadened so that the concessional tax treatment available under these structures is not restricted to early stage development but extends to any part of the life cycle of an eligible project from the point of initial development up to the commercialisation of a new or improved product, process or service.

We also recommend that the funding ceiling for early stage venture capital limited partnership be increased from \$100 million to \$200 million, and that an entity's maximum investment in a limited partnership be increased from the existing 30 per cent limit to 50 per cent.

***Dedicating resources to finalising improvements to the taxation regime for the financial services industry***

Australia's tax laws relating to financial services are outdated and do little to support Australia's aspiration of being a financial services hub.

Over the past five years, significant work has been undertaken to improve the taxation regime for financial services. This work includes the Board of Taxation's review of the managed investment trusts (MIT) and collective investment vehicles (CIVs), as well as developments on the investment manager regime (IMR). While the recent announcement by the Government on the IMR is welcome, we believe the government should dedicate additional resources to completing the introduction of new taxation regimes for the IMR and MITs.

In relation to CIVs, with our very large superannuation investment base, we believe we have a real opportunity to create a market leading industry in the Asia-Pacific region. With other jurisdictions improving the efficiency of their taxation treatment of CIVs, it is important that the Government complete with some urgency its review of the entire report by the Board of Taxation into the taxation treatment of CIVs from 2011 and release its response.