

**Submission to Treasury on the
Financial Systems Inquiry,
Final Report February 2015**

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INCOME IS THE **GOAL[™]**

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Material based on Financial System Inquiry Final Report February 2015, The Australian Government, The Treasury.

Tony McFadyen is Director, Campbell Lochbuie Pty Ltd in Australia. He operates the business name Income is the Goal [™]. This business consults to fiduciaries that seek to help super fund members build an inflation-protected income stream for life when they retire.

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Executive Summary

Income Is The Goal™ (IITG) is a consulting business in the Australian financial services market. Commenced in June 2014 by Tony McFadyen, the service aims to assist fiduciaries to move into a new paradigm, by focusing the strategic goals of their organisations on the real purpose of superannuation – providing an income in retirement for each and every member of their fund.

The Financial Systems Inquiry Final Report, February 2015 asks industry participants to respond. It is with pleasure that Income Is The Goal™ makes a response to the Final Report.

IITG believes the role of default superannuation funds is central to pre and post retirement policy, and that trustees should be mandated to act to improve the likelihood of each individual achieving their desired income in retirement. Trustees are able to mass customise their services, and administer accounts for individuals. It should therefore be superannuation funds' trustee responsibility to alter their business strategies to reflect that adequate income in retirement for individuals is the goal of their organisations, not the management of assets to beat some inflation or market index benchmark.

IITG agrees with the summation of the FSI Committee, that we have an inconsistent approach to our retirement income system. We have a mandatory superannuation saving system, with a strong default fund system and administration structure, albeit focused on the wrong goal.

IITG supports the excellent work done by the Inquiry and its staff presented in the Final Report. The emphasis on medium and long-term impacts and effectiveness of the superannuation system is appropriate. An efficient superannuation system is essential for Australia to meet the economic and fiscal challenges of an ageing population. The system is not 'broken', but suffers from constant change and participant uncertainty as a result of these changes. Change as a result of the FSI and Re:think Tax Discussion Paper, will be positive for Australia, but must be considered and not piecemeal. This is the chance for long term policy clean-up and reform.

Innovation and new services for our ageing population will emerge if Government, as a result of the work of the FSI Committee, :-

- legislates the long term objectives of the superannuation system,
- creates a superannuation and retirement regime that rewards self-reliance,
- continues to support those who need to rely on the pension,
- mandates trustees to provide a default option in retirement in line with the CIPR suggestion in the Report,
- eliminates regulatory/tax blockages that hamper people's ability to manage longevity risk (particularly in the area of deferred annuities) and
- consistently taxes all superannuation income throughout accumulation and decumulation, and in doing so rewards taking an income stream in retirement.

These efforts will be assisted by increased issuance of medium and long dated inflation linked bonds by Government, to allow people to save using their unique characteristics, and product providers to hedge their exposures as income stream products increase the use of inflation indexed securities as our population ages and retires.

The Final Report

ASFA identified 28 recommendations in the final report that either directly or indirectly impact superannuation and retirement incomes. IITG acknowledges ASFA's summary. The identified recommendations and their details appear below.

- 1 **Direct borrowing by superannuation funds (FSI recommendation 8)**
 - Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds.
- 2 **Objectives of the superannuation system (FSI recommendation 9)**
 - Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the long term.
- 3 **Improving efficiency during accumulation (FSI recommendation 10)**
 - Introduce a formal competitive process to allocate new default fund members to MySuper products, unless a review by 2020 concludes that the Stronger Super reforms have been effective in significantly improving competition and efficiency in the superannuation system.
- 4 **The retirement phase of superannuation (FSI recommendation 11)**
 - Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed.
- 5 **Choice of fund (FSI recommendation 12)**
 - Provide all employees with the ability to choose the fund into which their Superannuation Guarantee contributions are paid.
- 6 **Governance of superannuation funds (FSI recommendation 13)**
 - Mandate a majority of independent directors on the board of corporate trustees of public-offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements.
- 7 **Collaboration to enable innovation (FSI recommendation 14)**
 - Establish a permanent public-private sector collaborative committee, the 'Innovation Collaboration', to facilitate financial system innovation and enable timely and coordinated policy and regulatory responses.
- 8 **Digital identity (FSI recommendation 15)**
 - Develop a national strategy for a federated-style model of trusted digital identities.
- 9 **Data access and use (FSI recommendation 19)**
 - Review the costs and benefits of increasing access to and improving the use of data, taking into account community concerns about appropriate privacy protections.
- 10 **Strengthen product issuer and distributor accountability (FSI recommendation 21)**
 - Introduce a targeted and principles-based product design and distribution obligation.
- 11 **Introduce product intervention power (FSI recommendation 22)**
 - Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer

detriment.

12 Facilitate innovative disclosure (FSI recommendation 23)

- Remove regulatory impediments to innovative product disclosure and communication with consumers, and improve the way risk and fees are communicated to consumers.

13 Align the interests of financial firms and consumers (FSI recommendation 24)

- Better align the interests of financial firms with those of consumers by raising industry standards, enhancing the power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice.

14 Raise the competency of advisers (FSI recommendation 25)

- Raise the competency of financial advice providers and introduce an enhanced register of advisers.

15 Regulator accountability (FSI recommendation 27)

- Create a new Financial Regulator Assessment Board to advise government annually on how financial regulators have implemented their mandates.
- Provide clearer guidance to regulators in Statements of Expectation and increase the use of performance indicators for regulator performance.

16 Execution of mandate (FSI recommendation 28)

- Provide regulators with more stable funding by adopting a three-year funding model based on periodic funding reviews, increase their capacity to pay competitive remuneration, boost flexibility in respect of staffing and funding, and require them to undertake periodic capability reviews.

17 Strengthening the Australian Securities and Investments Commission's funding and powers (FSI recommendation 29)

- Introduce an industry funding model for the Australian Securities and Investments Commission (ASIC) and provide ASIC with stronger regulatory tools.

18 Strengthening the focus on competition in the financial system (FSI recommendation 30)

- Review the state of competition in the sector every three years, improve reporting of how regulators balance competition against their core objectives, identify barriers to cross-border provision of financial services and include consideration of competition in the Australian Securities and Investments Commission's mandate.

19 Compliance costs and policy processes (FSI recommendation 31)

- Increase the time available for industry to implement complex regulatory change.
- Conduct post-implementation reviews of major regulatory changes more frequently.

20 Impact investment (FSI recommendation 32)

- Explore ways to facilitate development of the impact investment market and encourage innovation in funding social service delivery.
- Provide guidance to superannuation trustees on the appropriateness of impact investment.
- Support law reform to classify a private ancillary fund as a 'sophisticated' or 'professional' investor, where the founder of the fund meets those definitions.

- 21 **Retail corporate bond market (FSI recommendation 33)**
 - Reduce disclosure requirements for large listed corporates issuing 'simple' bonds and encourage industry to develop standard terms for 'simple' bonds.
- 22 **Finance companies (FSI recommendation 35)**
 - Clearly differentiate the investment products that finance companies and similar entities offer retail consumers from authorised deposit-taking institution deposits.
- 23 **Superannuation member engagement (FSI recommendation 37)**
 - Publish retirement income projections on member statements from defined contribution superannuation schemes using Australian Securities and Investments Commission (ASIC) regulatory guidance.
 - Facilitate access to consolidated superannuation information from the Australian Taxation Office to use with ASIC's and superannuation funds' retirement income projection calculators.
- 24 **Cyber security (FSI recommendation 38)**
 - Update the 2009 Cyber Security Strategy to reflect changes in the threat environment, improve cohesion in policy implementation, and progress public-private sector and cross-industry collaboration.
 - Establish a formal framework for cyber security information sharing and response to cyber threats.
- 25 **Technology neutrality (FSI recommendation 39)**
 - Identify, in consultation with the financial sector, and amend priority areas of regulation to be technology neutral.
 - Embed consideration of the principle of technology neutrality into development processes for future regulation.
 - Ensure regulation allows individuals to select alternative methods to access services to maintain fair treatment for all consumer segments.
- 26 **Provision of financial advice and mortgage broking (FSI recommendation 40)**
 - Rename 'general advice' and require advisers and mortgage brokers to disclose ownership structures.
- 27 **Managed investment scheme regulation (FSI recommendation 42)**
 - Support the government's review of the Corporations and Markets Advisory Committee's recommendations on managed investment schemes, giving priority to matters relating to:
 - Consumer detriment, including illiquid schemes and freezing of funds.
 - Regulatory architecture impeding cross-border transactions and mutual recognition arrangements.
- 28 **Legacy products (FSI recommendation 43)**
 - Introduce a mechanism to facilitate the rationalisation of legacy products in the life insurance and managed investments sectors.

IITG Response to the FSI Recommendations

IITG agrees with ASFA's summation, and believes that our comments should focus on the key recommendations that impact the creation and subsequent provision of income streams in a person's retirement years.

In making our comments we have used the principles detailed in the Final Report, as we consider these to be highly appropriate in framing policy for superannuation. These Principles are

- Government intervention in the superannuation system should support a clear objective to provide income in retirement.
- Retaining freedom and choice within a compulsory system is fundamental to meeting the needs of individual superannuation fund members, even though this may involve costs.
- The efficiency of the superannuation system should be improved by policy measures aimed at removing barriers to innovation and increasing competitive pressures.
- In designing superannuation policy settings, policy makers should recognise and respond to consumers' significant behavioural biases.
- Individuals should bear responsibility for their financial decisions. However, because of mandatory contributions and the implications of Age Pension outlays for taxpayers, Government has a responsibility to adopt policy settings that deliver appropriate outcomes for superannuation fund members¹.

1 Direct borrowing by superannuation funds (FSI recommendation 8)

- Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds.

Agreed. Mandatory long term savings for the provision of retirement income should not be subjected to additional risk from leverage over specific assets that result in highly concentrated portfolio exposures.

2 Objectives of the superannuation system (FSI recommendation 9)

- Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the long term.

While governments have not declared in legislation the fundamental purpose of superannuation, a report prepared by the Charter Group in July 2013 on superannuation adequacy and sustainability suggested these objectives:

- to provide an adequate level of retirement income;
- to relieve pressure on the Age Pension; and
- to increase national savings, creating a pool of patient capital to be invested as decided by fiduciary trustees².

¹ Financial System Inquiry Final Report The Australian Government The Treasury, Feb 2015, P 94

² A Super Charter: Fewer Changes, Better Outcomes, The Australian Government, The Treasury, July 2013, P 21

IITG supports this summary, and would add that in the first point the focus should be the individual. In this way the objective function of superannuation is both community-based and individually focused. IITG would therefore amend the first objective:

- to provide an adequate level of retirement income for each Australian
- to relieve pressure on the Age Pension; and
- to increase national savings, creating a pool of patient capital to be invested as decided by fiduciary trustees.

3 Improving efficiency during accumulation (FSI recommendation 10)

- Introduce a formal competitive process to allocate new default fund members to MySuper products, unless a review by 2020 concludes that the Stronger Super reforms have been effective in significantly improving competition and efficiency in the superannuation system.

IITG agrees that it is too early to make informed comment on whether MySuper has been effective. In this case it is appropriate to wait until 2020 to review the systems effectiveness. Indeed we will not know the efficacy of the entire superannuation system until at least one whole generation has lived through the system, from first entering the workforce to retirement and creating a retirement income from their savings in superannuation. As compulsion only commenced in 1992 with the superannuation guarantee, we may not be able to properly comment until 2030 when the first group of compulsory superannuants move into retirement. Or it may even be later when these people have lived through their retirement.

4 The retirement phase of superannuation (FSI recommendation 11)

- Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed.

Empirically the research presented on pages 4.21-4.23 of the Interim Report (July 2014) suggests benefits from government designing a post retirement default structure. However there is much community history and expectation to be overcome if government goes all the way to mandating a certain default post retirement structure. IITG suggests that government prescribe minimum policy structures, without hard and fast breakpoints or mandatory features. Fiduciaries should be encouraged to create default structures for their funds, recognizing the needs of their members.

The difficulty is in even suggesting policy guidelines is that much work needs to be done to ensure products with strong benefits (such as annuities or deferred annuities) should not be taxed so that they are rejected on that basis. Similarly, deeming rules and the asset test for the age pension (for example) need to be realistically applied with respect to all assets. And if the objective of the superannuation system is to provide income in retirement then there should be positive tax and age pension eligibility bias towards income stream products and elections not to take lump sums at retirement.

These comments were reflected in the Final Report (Pages 117 – 130).

IITG supports the FSI where it states from page 127 of the Final Report that “Government would need to consider how the Age Pension means test applies to new income stream products. In principle, the means test should not discourage products that manage longevity risk, should aim to provide neutral treatment of products with longevity risk protection, and should not make it difficult for individuals to smooth their income and consumption over retirement. Without some amendments to the Age Pension means test, some CIPRs could increase the cost of the Age Pension to taxpayers.”³

CIPRs (comprehensive income product for retirement) are unlikely to be a single product, although they may be packaged by superannuation funds that way for members. It is more likely that the trustee will combine products with certain characteristics to provide the longevity protection and income for life in retirement for members. It is vital that tax impediments for deferred annuity structures be removed so that trustees can provide these types of income streams to members.

5 Choice of fund (FSI recommendation 12)

- Provide all employees with the ability to choose the fund into which their Superannuation Guarantee contributions are paid.

Agreed. This confirms the policy of defined contribution pensions and the risk transfer to individuals. If the risk has been transferred to the individual for the outcome it is appropriate for those individuals to have choice in where their contributions are directed.

6 Governance of superannuation funds (FSI recommendation 13)

- Mandate a majority of independent directors on the board of corporate trustees of public-offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements.

Agreed. IITG believes that improving talent in governance is a good objective within superannuation. However we should recognize that many current trustees have substantial skills and simply saying that due to past associations they do not have the requisite skills to be on the board of a public offer superannuation fund may not be accurate. Transition timeframes and board skills audits that proved competence may alleviate the need to rapidly change board composition.

7 Collaboration to enable innovation (FSI recommendation 14)

- Establish a permanent public–private sector collaborative committee, the 'Innovation Collaboration', to facilitate financial system innovation and enable timely and coordinated policy and regulatory responses.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

³ Financial System Inquiry Final Report The Australian Government The Treasury, Feb 2015, P 127

8 Digital identity (FSI recommendation 15)

- Develop a national strategy for a federated-style model of trusted digital identities.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

9 Data access and use (FSI recommendation 19)

- Review the costs and benefits of increasing access to and improving the use of data, taking into account community concerns about appropriate privacy protections.

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- Introduce a targeted and principles-based product design and distribution obligation.

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- Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.

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- Better align the interests of financial firms with those of consumers by raising industry standards, enhancing the power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not

affect the quality of financial advice.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

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- Raise the competency of financial advice providers and introduce an enhanced register of advisers.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

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- Create a new Financial Regulator Assessment Board to advise government annually on how financial regulators have implemented their mandates.
- Provide clearer guidance to regulators in Statements of Expectation and increase the use of performance indicators for regulator performance.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

16 Execution of mandate (FSI recommendation 28)

- Provide regulators with more stable funding by adopting a three-year funding model based on periodic funding reviews, increase their capacity to pay competitive remuneration, boost flexibility in respect of staffing and funding, and require them to undertake periodic capability reviews.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

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IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

18 Strengthening the focus on competition in the financial system (FSI recommendation 30)

- Review the state of competition in the sector every three years, improve reporting of how regulators balance competition against their core objectives, identify barriers to cross-border provision of financial services and include

consideration of competition in the Australian Securities and Investments Commission's mandate.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

19 Compliance costs and policy processes (FSI recommendation 31)

- Increase the time available for industry to implement complex regulatory change.
- Conduct post-implementation reviews of major regulatory changes more frequently.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

20 Impact investment (FSI recommendation 32)

- Explore ways to facilitate development of the impact investment market and encourage innovation in funding social service delivery.
- Provide guidance to superannuation trustees on the appropriateness of impact investment.
- Support law reform to classify a private ancillary fund as a 'sophisticated' or 'professional' investor, where the founder of the fund meets those definitions.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

21 Retail corporate bond market (FSI recommendation 33)

- Reduce disclosure requirements for large listed corporates issuing 'simple' bonds and encourage industry to develop standard terms for 'simple' bonds.

Agreed. IITG acknowledges the need to create deeper markets for fixed income securities across a wider range of credit opportunities.

22 Finance companies (FSI recommendation 35)

- Clearly differentiate the investment products that finance companies and similar entities offer retail consumers from authorised deposit-taking institution deposits.

Agreed. IITG agrees that authorized institutions should be clearly recognized from finance companies and other companies with lesser credit ratings.

23 Superannuation member engagement (FSI recommendation 37)

- Publish retirement income projections on member statements from defined contribution superannuation schemes using Australian Securities and Investments Commission (ASIC) regulatory guidance.
- Facilitate access to consolidated superannuation information from the

Australian Taxation Office to use with ASIC's and superannuation funds' retirement income projection calculators.

Agreed. IITG strongly supports the requirement to provide retirement income projections on the statements that members receive from their superannuation fund/s. This measure, coupled with an ability for funds to access ATO superannuation information for individuals that is consolidated, will provide members with more realistic estimates of their income in retirement.

24 Cyber security (FSI recommendation 38)

- Update the 2009 Cyber Security Strategy to reflect changes in the threat environment, improve cohesion in policy implementation, and progress public-private sector and cross-industry collaboration.
- Establish a formal framework for cyber security information sharing and response to cyber threats.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

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- Identify, in consultation with the financial sector, and amend priority areas of regulation to be technology neutral.
- Embed consideration of the principle of technology neutrality into development processes for future regulation.
- Ensure regulation allows individuals to select alternative methods to access services to maintain fair treatment for all consumer segments.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

26 Provision of financial advice and mortgage broking (FSI recommendation 40)

- Rename 'general advice' and require advisers and mortgage brokers to disclose ownership structures.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

27 Managed investment scheme regulation (FSI recommendation 42)

- Support the government's review of the Corporations and Markets Advisory Committee's recommendations on managed investment schemes, giving priority to matters relating to:
 - Consumer detriment, including illiquid schemes and freezing of funds.
 - Regulatory architecture impeding cross-border transactions and mutual recognition arrangements.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.

28 Legacy products (FSI recommendation 43)

- Introduce a mechanism to facilitate the rationalisation of legacy products in the life insurance and managed investments sectors.

IITG does not believe it appropriate to respond to the detail of this recommendation, and consider that other organisations with tax, legal, regulatory and other specific skills are better placed to offer an opinion.