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10 April 2013

Mr Stephen Powell
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Department of Treasury
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Sent via: futureofadvice@treasury.gov.au; stephen.powell@treasury.gov.au

Dear Mr Powell

Exposure Draft - FOFA Regulations on Grandfathering

Thank you for the opportunity to comment on the draft Corporations Amendment Regulation 2013 (No. F). On behalf of the Friendly Societies of Australia (FSA), Abacus-Australian Mutuals appreciates the extension of time provided to us to lodge this submission on the FOFA grandfathering regulations.

Through an agreement with the FSA, Abacus represents 13 friendly societies, with $6.1 billion in assets under management.

Friendly societies help Australians become financially independent and plan for life events through the provision of savings, investment and insurance products. These include investment bonds, education savings plans, superannuation products, health, risk and travel insurance and funeral plans.

Friendly societies that offer financial products are regulated by APRA under the *Life Insurance Act 1995*, as well as by ASIC under the *Corporations Act 2001*.

Friendly societies have traditionally been involved in encouraging and supporting self-help within the community, and were founded on the concepts of thrift, savings and the pooling or sharing of risks within a community.

Issue
Friendly society investment bonds are not covered by the grandfathering regulations, while competitor investment products are covered.

Recommendation
Draft regulation 7.7A.16A should be amended to include a new paragraph (6) to allow the proposed grandfathering arrangements for the ban on conflicted remuneration in relation to further investments, to apply to investment bonds issued under the *Life Insurance Act 1995* in a similar fashion to the regulations proposed to apply to managed investment schemes (paragraph 4) and superannuation schemes (paragraph 5).

Nature of investment bonds
Investment bonds are similar in nature to managed investment and superannuation schemes with respect to the fact that investors are able to make additional and ongoing contributions over an extended period of time.

Specifically, investment bonds are multi-purpose life event savings vehicles that are used to prepare for a wide range of life events, such as funding education costs, house deposits and health and aged-care costs.

These bonds are long term investments designed to be held for at least 10 years that allow for regular contributions. Bonds do not distribute regular income to investors, however income is re-invested to achieve a compounding effect.

10 year tax rule
If the investor has held an investment bond for 10 years or more, earnings do not need to be declared in tax returns and no additional tax or capital gains tax is payable. If an investor does withdraw prior to the ten year period, they will need to declare the earnings in their tax return. Tax offsets are available for withdrawals made within the specified withdrawal periods.

The 125% rule
Investors can contribute as much as they wish during the first year. Additional contributions can be made each year of up to 125% of a previous year's contributions with the benefit of these contributions being treated as if they were invested at the same time of the original investment. Upon expiry of the full ten year term, these additional contributions also acquire a tax paid status. If additional contributions exceed 125% of a previous year's contribution, the ten year term will re-set and a new ten year period is deemed to commence.

For these reasons, it is likely that investors who enter into investment bonds before 1 July 2013 will continue to make additional and ongoing contributions into the future.

Policy rationale
The omission of investment bonds issued under the *Life Insurance Act 1995* from regulation 7.7A.16A of the draft regulations appears to be an oversight.

As currently drafted, the grandfathering arrangements in relation to further contributions beyond 1 July 2014 on investments made before 1 July 2013 will distort competitive neutrality.

The draft regulations will deliver a substantial competitive advantage to managed investment and superannuation schemes while imposing a punitive regime on friendly societies and other issuers of investment bonds.

Friendly societies will bear an unfair burden if the FOFA framework denies them a remuneration stream that is being proposed for similar and competing retail investments.

Insurance bonds are included in financial plans by financial advisers, either in substitution for, or to complement, other managed funds and superannuation. These bonds operate from an adviser remuneration perspective as if they were a managed fund or superannuation product. It is therefore essential that past insurance bond remuneration arrangements with advisers should continue on the same basis under FOFA grandfathering provisions as other investment products.

The omission of investment bonds from the draft grandfathering arrangements cannot be justified on consumer protections grounds given the *Life Insurance Act 1995* maintains a concerted focus on consumer protection.

The principal object of the *Life Insurance Act 1995* "is to protect the interests of the owners and prospective owners of life insurance policies in a manner consistent with the continued development of a viable, competitive and innovative life insurance industry."

The following objects of the *Life Insurance Act 1995* illustrate the highly regulated framework which applies to friendly societies.

"(1A) An additional object of this Act is to protect the interests of persons entitled to other kinds of benefits provided in the course of carrying on life insurance business (including business that is declared to be life insurance business).

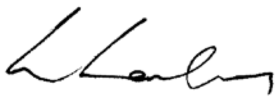
(2) The principal means adopted for the achievement of these objects are the following:

a) restricting the conduct of life insurance business to companies that are able to meet certain requirements as to suitability;
b) imposing on life companies requirements designed to promote prudent management of the life insurance business of such companies, including requirements designed to ensure the solvency and capital adequacy of statutory funds;
c) providing for the supervision of life companies by APRA and ASIC;
d) providing for judicial management of life companies whose continuance may be threatened by unsatisfactory management or an unsatisfactory financial position, so as to protect the interests of policy owners and financial system stability in Australia;
e) making provision to ensure that, in the winding-up of a life company, the interests of policy owners are adequately protected;
f) providing for the supervision of transfers and amalgamations of life insurance business by the Court."

It is within this framework that APRA imposes an intensive supervisory regime on the performance of friendly societies. Coupled to this is a deep seated heritage, dating back to 1830, that commits friendly societies to help Australians become financially independent and plan for life events.

Please contact Jim Aliferis, Senior Policy Adviser, on 02 8035 8442 or jaliferis@abacus.org.au to discuss any aspect of this submission.

Yours sincerely



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