



5 December 2013

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

Dear Sir/Madam

Financial System Inquiry – Draft Terms of Reference

The Actuaries Institute welcomes the Government's invitation to comment on the draft terms of reference for the Financial System Inquiry.

The Actuaries Institute is the sole professional body for actuaries in Australia. It represents the interests of almost 4,000 members, including more than 2,000 qualified actuaries. Our members have had significant involvement in the development of superannuation and insurance regulation, financial reporting, risk management and related practices in Australia and Asia.

Actuaries have been at the heart of successfully managing risk in insurance organisations for many decades. Our expertise in insurance, market, and operational risk management for insurance organisations has broadened out considerably over recent years to encompass the full enterprise risk management spectrum for many industries such as superannuation, wealth management, banking, financial planning, and energy, amongst others. Actuaries now hold senior risk management roles in these industries, and are supported by a strong commitment of the Institute to meet their ongoing and evolving needs.

In recent years, there has been an increase in the number of Actuaries working in senior roles within the banking sector in Australia and overseas. Many of these Actuaries have experience in other areas of the Financial Service industry and with their banking experience are well placed to provide balanced views on how banking compares to other areas.

Commentary

The Institute is supportive of the Government's desire for a 'root and branch' examination of the nation's financial system and its intention to foster an efficient, competitive and flexible financial system, consistent with financial stability, prudence, integrity and fairness. We believe it would be interesting for the review to reflect on whether the Finance Sector has the ability to evolve naturally making improvements with market forces in a manner that satisfies other objectives such as consumer protection and stability or whether more formal reviews such as this one are generally required every 10 to 20 years.

The draft terms of reference are broad and therefore provide adequate scope for a comprehensive review of the financial system. Some clarity around what timeframe the financial system inquiry will consider would be useful to ensure expectations are clear.

Institute of Actuaries of Australia

ABN 69 000 423 656

Level 7, 4 Martin Place, Sydney NSW Australia 2000

t +61 (0) 2 9233 3466 f +61 (0) 2 9233 3446

e actuaries@actuaries.asn.au w www.actuaries.asn.au



In relation to the specifics of the proposed terms of reference we discuss below what we believe could be some key areas for potential focus.

1. The Inquiry will report on the consequences of developments in the Australian financial system since the 1997 Financial System Inquiry and the global financial crisis.

We believe it is important to ensure we have an integrated financial system that is competitive on international levels and that does not unduly disadvantage our local providers but provides environments that enable our institutions to compete globally.

As actuaries, we have expertise in the monitoring of financial security systems. We believe the industry could benefit as a whole from having better feedback mechanisms in place, in order to understand much more completely and dynamically changes in the financial services "system". Given the size and impact of the industry, we believe it would be beneficial if there was an increase in the level of *important* information gathered and analysed in order to ensure the financial system achieved its goals with minimal negative impacts. Currently there is very limited data released on the insurance and banking industries and almost non-existent data on housing / mortgage markets and the broader changes in the accumulation, distribution and use of wealth that will define the financial services landscape over the coming decades. Much of this data is still displayed in 1980's style reports and simple spreadsheets, compared to where other industries are at such as communications, media, mining, energy, transport, retail etc. This review could be the catalyst for making a transformational rather than incremental shift.

2. The Inquiry will refresh the philosophy, principles and objectives underpinning the development of a well-functioning financial system.

We believe there is significant value for enterprises to adopt a modern risk management framework however the recent regulatory reform agenda risks turning much of the well-intentioned reform into a cost-focused compliance exercise. It is imperative that the regulatory framework encourage appropriate risk management practices. It therefore seems appropriate a review is undertaken to find the right balance between prescribing minimum requirements and encouraging senior decision makers to manage risks effectively.

The structure and content of regulation is important but we believe the education and development of ethical and competent professionals (people who speak up before things go badly wrong) and their role in the governance of the system is also important and should be included as part of the reviews considerations. The issue of market efficiency versus prudential security in the financial sector if adequately debated could be of significant benefit to APRA in determining the appropriate balance. We believe it is important that the cost of regulation is balanced with the safety of the system as this ensures cost effective regulation.

3. The Inquiry will identify and consider the emerging opportunities and challenges that are likely to drive further change in the financial system.

Australia is experiencing a major demographic and societal transformation. By 2050, almost a quarter of the population will be aged over 65 compared to 14% now. We believe a key focus of this inquiry should include what role the finance industry should play in helping to find solutions to this longevity challenge we are facing as a community.



The Inquiry could investigate the extent to which the financial system supports, encourages and is effective in the preplanning and build up of savings or wealth to meet foreseeable long term needs of individuals and Australian society overall e.g retirement income solutions, aged care and future health costs. Considerations in this area could include development of a market for transferring longevity risk, sustainability of retirement lump sum payment preferences, appropriateness of SMSF's, and alignment of superannuation tax incentives with community needs.

Where appropriate we believe it is important to review the harmonisation of regulation between different types of manufacturers such as banks, wealth managers, retail insurers, industry funds, and SMSF's. This should also extend to different parts of the supply chain to ensure that there are at least no material regulatory misalignments between customers, distributors, manufacturers and broader stakeholders such as regulators and government.

4. The Inquiry will recommend policy options

Although the financial system inquiry is primarily focused on banking considerations we believe the role of insurance, both life and general, in the financial system and the challenges the industry and its policy holders are facing could also be examined within the inquiry e.g. how it contributes to efficiency and stability, the level of insurance (e.g. under insurance in life insurance) and the affordability of insurance.

We also believe the financial system inquiry should cover the regulatory framework around our biggest asset and liability market – residential housing and mortgages as there are many complex issues here that go beyond just financial services, particularly from an intergenerational equity perspective.

We would of course be very pleased to discuss our views on the Financial Systems Inquiry with you. Our new, Chief Executive Officer, David Bell will commence with the Institute on the 20th January (phone 02 9239 6106)). If you have any queries before then please do not hesitate to contact our Deputy CEO, Elayne Grace (phone 02 9239 6128 or email Elayne.grace@actuaries.asn.au).

Yours sincerely

John Newman
President