

The Hon Chris Pearce MP

Shadow Minister for Financial Services, Superannuation and Corporate Law

Association of Financial Advisers:

The Future of Financial Advice in Australia

Crown Towers Palladium

24 March 2009

Good afternoon ladies and gentlemen. Financial advice and of course the role of the financial services industry have been central elements in the current debate on the origins of the global economic crisis.

Australia's Financial System

From a macro perspective, there can be no doubt that a significant amount of the problems leading to the current turmoil can be attributed to a failure of financial regulation overseas.

From the outset, I'd like to make an important point. Such failures have not been experienced in our country.

We are all aware of the failure of and the nationalisation of significant banking and financial institutions in the United States and Europe. Again, this has not been the case here. Our banking and financial institutions have been weathering the storm well.

The prudential and supervisory framework established in Australia by the former Coalition Government after the Wallis inquiry in 1997 has held us in good stead.

The Wallis reforms resulted in the establishment of the twin peaked regulatory regime of APRA and ASIC, which have provided us with a robust prudential and supervisory framework.

Clearly, these reforms struck the right balance between government intervention and free-market forces.

Of course the Rudd Labor Government is fond of saying that the Opposition is the party of 'letting the market rip' and that we are proponents of 'extreme capitalism.' They are interesting assertions.

After establishing the prudential framework which has played such an important role in insulating us from the global turmoil, I would say that the facts speak for themselves and the government's claims are simply false.

My great concern from a practical viewpoint is that these statements are being used to foreshadow and attempt to justify wholesale financial system reform.

The Coalition's position is that we would be reluctant to support any unjustified politically driven reforms to our financial system emerging from Labor's 'extreme capitalism' thesis. We hold that our financial system and regulatory regime is robust, competitive and appropriate.

Parliamentary Inquiry

As AFA members would be aware, only a few weeks ago, the Parliamentary Joint Committee into Corporations and Financial Services instituted an inquiry into certain collapses relating to financial services and products in Australia.

I am a member of this committee in my capacity as the relevant Shadow Minister. The Committee's terms of reference include an examination of the role of financial advisers, the general regulatory environment for these products and services and the need for any legislative or regulatory change.

The committee will also be examining the recent collapses of financial services companies. In particular, we will be looking at the role of advertising and marketing, licensing and consumer education.

I echo my earlier comment on widespread financial sector reform. In the context of the inquiry, whilst there may be the need for some targeted legislative changes, it will be interesting to see if there is any real justification for changes to our financial system across-the-board.

Financial Advice

There are a number of significant issues I want to address in relation to financial advice.

The first is access to financial advice. In our society I believe it is important that people have access to appropriate financial advice. Financial planners and advisers can assist people from all walks of life in arranging their financial affairs for a more secure future.

Policymakers of course play an important role in ensuring that people have access to advice and can do so within a safe and appropriate framework. One of the best incentives that can encourage people to seek financial advice is, of course, through the tax system.

Currently there are provisions for tax deductible financial advice where it is provided on an ongoing basis. Up-front fees are generally non-deductible. Industry sources argue that this may be an impediment to procuring advice. This may well be the case. Simple financial advice is often provided in an up-front manner as a once-off. Such advice may involve basic matters such as consolidation or tidying-up of a person's finances.

If we're going to have tax-deductible financial advice, I think it should be focused on encouraging those who would not otherwise seek advice to do just that.

Therefore, the tax deductibility provisions, whether up-front or ongoing, could be revisited in order to encourage the uptake of advice and planning.

Advice and Disclosure

Of course there are the perennial issues around advice disclosures and protection.

As Parliamentary Secretary to the Treasurer in the last government, I endeavoured to address several issues around the rather cumbersome *Corporations Act* disclosure requirements through FSR refinements. Our work on PDS, SOA and FSG simplification was a significant improvement. I am pleased that the current government is continuing this important work. There is no doubt, and I'm sure that AFA members would know this more than most: that further simplification in this area is needed.

There is further work which could be done in terms of the issuance of simple intra-product advice. In some cases where such advice is sought it may not actually be necessary for an SOA to be issued in this circumstance.

Whilst the current structure has been designed to provide a framework that establishes protection for those seeking advice, again it can be too cumbersome.

The *Corporations Act* could be amended to permit intra-product advice without an SOA where non-comparative external information is not being sought. Under such a regime, only appropriately trained and accredited employees would be allowed to tender simple financial advice.

Any such simplified advice mechanism would particularly assist superannuation funds in tending investment selection advice. It could also be used for assisting superannuants in determining the implications of tax and risk. Intra-product advice is therefore worthy of our consideration in assisting superannuants in making prudent decisions for their financial future.

Financial Literacy

In many ways, advice goes hand-in-hand with enhanced financial literacy. Indeed they complement each other.

Upon the election of the Rudd Labor Government, the Financial Literacy Foundation was transferred to ASIC as a part of Labor's razor gang cuts.

This Labor cut-back indicates a lack of concern and understanding of the importance of financial literacy to Australians in a modern, financially-centred economy.

As you know, ASIC is Australia's corporate, markets and financial services regulator, an important role considering the growing importance of financial and professional services to Australia's economy. The Coalition believes that government authorities should not have their key duties confused. ASIC's primary role is to regulate the market, not run a Financial Literacy Foundation

We understand that financial literacy to be an important and distinctive issue, one which requires dedicated resource deployment. However, I believe that financial literacy should be promoted through a dedicated body.

The Superannuation System

Superannuation is, of course, our largest pool of private savings in this nation. It has delivered significant national savings and provided much needed liquidity to our marketplace.

I understand how important superannuation is to AFA members and I've been asked to comment on the system and the key challenges in the sector.

Our superannuation system has recently received some criticism. People have asked, is superannuation the right vehicle for the future? Of late, the return on superannuation like all other market-linked investments has been far from optimal.

The average balanced superannuation option returned -20% over the past year.

Including the global crisis, which has had the worst impact on stock markets since the Great Depression, the average annual return to superannuation members have remained in positive territory.

Average returns have been +6.1% over the past five years and +5.9% over the past ten years. I don't think we should lose sight of the potential of superannuation over the longer term to provide for a financially secure retirement.

The combination of steady returns, reducing fees and increasing portability suggest that the super system is well-structured to serve as a key pillar of our retirement strategy.

Our system is of course heavily reliant upon choice and competition in providing the best possible returns to fund members.

Our hybrid system enjoys the best of both worlds. Successive governments have recognised that through private sector innovation, efficiency and competition, better returns would be delivered to all Australians. The government's role is to intervene with regulation only when appropriate and fully justified.

An important element of the private-sector management of superannuation (and essential to any sector of a free market economy) is competition.

Competition is essential in providing an efficient market. Curtailing competition sends the wrong message.

This is particularly the case when we consider that Choice of Fund legislation has provoked a rise in the exercise of choice.

Retrograde changes involving default funds initiated by the Rudd Labor Government under the guise of award 'modernisation' adversely impact large parts of the system.

These initiatives threaten to undermine progress made in improving returns to members in recent years through increased choice and competition. We will continue to advocate that any lessening of choice and competition cannot be justified and is fact detrimental to all Australians.

I see the two most significant issues in superannuation to be adequacy and longevity risk. People ask, do I have enough superannuation? Will I outlive my superannuation?

In terms of adequacy, the Coalition does not support any increase in the Superannuation Guarantee. We consider that any increase would be a substantial cost that would be borne by employers at a time where we should be attempting to preserve and create jobs.

An increase in the guarantee would directly increase the *cost of employment* to employers. Despite this our focus must remain on enhancing retirement nest eggs. This can be best achieved through targeted measures that are flexible.

In previous addresses on this topic I've raised the issue of opt-out soft compulsion, where post-tax contributions above the Superannuation Guarantee are automatically contributed unless the employee chooses to opt-out. Such a measure would positively tap into the apathy that many people hold towards superannuation.

Soft compulsion would result in increased account balances without imposing a uniform cost upon employers. It has been trialled with success in some areas of the private sector, in New Zealand and in the Tasmanian Public Service.

For low and middle income earners I've discussed the problem of increased inadequacy. Some measures which could be deployed to address these particular problems include examining the contributions tax levied on low income earners and a widening of the Co-Contribution Scheme.

As far as longevity risk goes, there is a lack of appropriately tailored products to insure people against the risk of outliving their superannuation. AFA members will be acutely aware that Australia has a dry annuities market. Indeed I'm told that there is currently only one provider which is writing annuities.

For a number of months I've been discussing the prospect of government providing the appropriate framework and incentive for a private sector solution to the issue of longevity risk.

There are two primary enablers that government can look at in this area. Government needs to make the business of annuity (be it traditional or 'hybrid') at least viable.

The government could therefore look at releasing long-dated CPI-linked bonds. Such bonds would allow retirement income product providers to match their liabilities and provide them with the certainty they need to write these products.

A further issue that needs to be looked at is the legislative definition of a retirement income stream.

While traditional annuities currently fit the definition of concessional tax status, 'hybrid' annuities do not.

Hybrid annuities include components of fixed and variable income. Whilst this is a complex area of taxation law, I believe it to be worthy of further consideration.

We must continue in our efforts to provide an appropriate mix of financial products in insuring against longevity risk. Undoubtedly there is an unmet appetite for the risk averse, particularly in light of the current financial turmoil.

Summary

There remains important work to do around the provision of financial advice and planning.

I also believe there is much to be done around enhancing and simplifying advice. As always, the disclosure of advice and consumer protection is of the utmost importance. Without doubt there is a significant role for government in this area in getting the advice and disclosure regime right for all participants.

I believe superannuation to be the best system to provide a secure retirement. I've outlined our key principles which are to improve adequacy, address longevity risk and to promote choice and competition.

Like the broader financial system in this country, superannuation requires targeted reforms only.

I believe these Coalition principles are the right response to meet the challenges we face today and most importantly prepare us all for the future.

I thank the AFA for the opportunity to speak with you today.