Submission to the Financial Systems Inquiry

March 2014

National Seniors Australia

Table of Contents

1 Introduction

National Seniors Australia welcomes the opportunity to make a submission to the current inquiry into the Australian financial system, the first comprehensive review since the 1997 Wallis Inquiry.

A fair, efficient and stable financial system is essential to the effective functioning of the Australian economy and society. While natural resources, talent and technology are the engines of economic growth, financial services represent the oil that lubricates virtually every aspect of economic activity.

National Seniors is Australia's largest organisation representing the interests of those aged 50 and over, with around 200,000 individual fee-paying members nationally. This broad based support enables National Seniors to provide a well informed and representative voice on behalf of its members and contribute to public education, debate and community consultation on issues of direct relevance to older Australians.

As the consumer lobby for the over-50s, National Seniors has a significant interest in the operation of the financial system. Older Australians represent a large and growing population of users of financial services, with those retired or approaching retirement increasingly reliant on financial products, fund managers and financial advisers and on the stability of the system as a whole to sustain them throughout their retirement years.

Older Australians also have a clear interest in a financial system that supports productivity and funds economic growth. A strong and growing economy offers the best prospect of Australia meeting the twin challenges of structural adjustment and fiscal repair. Sustaining high rates of economic growth will become more challenging as Australia's population ages and, as well as access to capital to fund growth, will also require efforts to improve labour force participation, including improving employment for older Australians who are able and willing to work.

2 Executive Summary

The financial system has generally served Australia well. However, it is timely to review its operation and regulation in light of significant developments and events since the Wallis and earlier Campbell inquiries established the current regulatory philosophy and framework.

Unquestionably, the event that subjected the system to its biggest test was the Global Financial Crisis. That Australia withstood the crisis relatively well can be attributed in part to the strength and resilience of its financial system. Nevertheless, the GFC, together with a series of domestic financial failures, revealed some systemic weaknesses, pointing to the need to shift the balance of regulation towards greater stability and consumer protection.

Other key developments since the Wallis inquiry to have shaped today's financial system include:

- Further global integration has brought significant economic benefits while also exposing Australia to greater risk of contagion from financial stability elsewhere in the world;
- Ongoing technological innovation has transformed the nature of financial institutions and products and altered the very structure and composition of the finance industry;
- Rapid growth in the superannuation sector has been shifting the centre of gravity of the financial system increasingly towards superannuation funds;
- Population ageing and rising wealth have accelerated growth in demand for financial services, particularly for funds management, financial planning and advice;
- Retirement incomes policies have been shifting the burden of financial and longevity risk away from government and financial institutions and onto individuals and households; and
- Increasing complexity has made it more difficult for individuals to navigate the financial system without professional assistance, adding to costs and risks for consumers.

The focus of this submission is on the implications of these developments and events for older Australians. These are summarised below and discussed in more detail in the body of the submission.

Balancing efficiency, safety and stability within the financial system

As a large and growing body of financial services consumers, older Australians have a low appetite for risk. A key lesson from the GFC and the series of domestic financial failures that have occurred over the past decade is the need for some rebalancing of the system of financial regulation towards greater stability and safety for end users.

National Seniors supports the maintenance of additional safeguards to protect savings deposits introduced in the wake of the GFC. Many older Australians hold their savings in bank deposits - whether as insurance against rainy day events, or because they believe this is the only way of guaranteeing the safety of their savings.

> ***Recommendation***
> ***The Financial Claims Scheme appears to offer an effective way of protecting depositors against systemic risk and should be retained in some form***

An issue for the Inquiry will be whether this scheme may have adversely affected competition between banks and non-bank institutions. National Seniors believes it is important to maintain a healthy degree of competition within the financial system as this offers the best prospect of fostering innovation, providing choice and keeping downward pressure on costs to consumers.

> ***Recommendation:***
> ***To achieve a better balance of safety, stability and efficiency considerations, the Inquiry should consider how best to address competition concerns, including whether an up-front fee would assist in offsetting any competitive advantage enjoyed by institutions covered by the scheme.***

While the aftermath of the GFC has seen action taken to strengthen prudential regulation of financial institutions to address safety concerns, a philosophy of light-handed disclosure regulation still underpins much of the regulation of financial markets and financial advisers. Yet, the series of domestic financial failures that have occurred over the last decade provide ample evidence that disclosure, education and advice alone are insufficient to protect consumers in an increasingly complex financial system. The retirement savings of many older Australians have been irreparably damaged by these events.

The Future of Financial Advice reforms went some way towards addressing this situation, in particular by prohibiting conflicted remuneration, requiring consumers to opt in to ongoing advice, mandating annual fee disclosure and introducing a specific duty for advisers to act in clients' best interest; however proposed amendments to these reforms by the incoming government would remove this core protection. National Seniors considers there can be no genuine protection of consumers of financial advice services so long as conflicted remuneration is allowed. In addition, fundamental conflicts of interest inherent in the vertical integration of financial advisory services with financial product providers need to be tackled.

> ***Recommendation:***
> ***In considering how best to balance safety and efficiency considerations, the Inquiry should consider how conflict of interest in the financial advice sector can be effectively eliminated while vertical integration of financial product suppliers with financial planning and advisory services is permitted***.

Increasing complexity has made it more difficult for individuals to navigate the financial system without assistance, adding additional costs and risks for consumers.

> ***Recommendation:***
> ***The inquiry should consider how to better protect ill-informed consumers who, in managing their financial affairs, are increasingly being made reliant on professional advice to navigate complex systems and products.***

A further source of increased complexity that particularly affects senior Australians is the growing interdependence between superannuation, the age pension, the tax system and the aged care system. The interplay between these systems is further complicated by frequent changes of policy and regulation.

> ***Recommendation:***
> ***Whenever a change is proposed to either taxation, social security, superannuation, life insurance or aged care arrangements, at either federal or state level, the associated regulatory impact statement should consider the implications for each of the other policy areas listed.***

With superannuation funds becoming a much more significant source of domestic savings to fund growth, there is some risk that future governments will seek to mandate particular asset allocations by superannuation funds in order to promote sectoral or broader economic growth objectives.

While the superannuation sector may be a natural source of capital to fund certain classes of investment - such as public infrastructure - there must be no attempt to mandate super fund participation in this or any other specific investment class. Each investment must be assessed on its own merits, including the risks involved.

> ***<u>Recommendation</u>:***
> ***It is imperative that the long term interests of fund members remain the sole purpose of superannuation funds. The Murray inquiry should consider increasing safeguards to prevent superannuation funds being directed towards investments designed to promote other purposes, such as particular national or sectoral growth objectives***.

Growing individual exposure to market risk

Among the more disturbing trends since the current financial regulatory architecture was put in place is the growth in the exposure of individuals and households to market risk. This is being driven by a retirement incomes policy that relies on a mix of compulsory and voluntary superannuation savings to shift Australians progressively towards greater self-reliance in old age.

Together with rising longevity (discussed below), this is driving a substantial reallocation of the burden of financial risk from government and financial institutions to households. If the retirement income system is to achieve its aim of making older Australians more financially independent, there must be action to address current impediments to the management of both market and longevity risk for current and future superannuation fund members.

> ***<u>Recommendation</u>:***
> ***That the Inquiry consider how best to address growing individual exposure to market risk, including:***
> - ***Are current arrangements for the safety and stability of the financial system as a whole still targeted to where risk is most concentrated?***
> - ***Do current arrangements for the governance and prudential oversight of superannuation funds adequately address the growing exposure of households – and particularly retirees – to financial risk?***
> - ***Should APRA direct the funds management sector to separate income and capital unit prices in order to increase transparency regarding the risk profile of investment options?***
> - ***Should superannuation trustees be encouraged to direct investment strategies in the pension phase towards annuities and other more secure income yielding investments?***

Addressing longevity risk

Older Australians also face a growing burden of longevity risk as a result of the increasing focus of retirement incomes policy on financial self-reliance. While the Wallis inquiry did foreshadow this issue, life expectancy has risen sharply since that time, adding to longevity risk for both current and future retirees.

It is therefore a matter of growing concern that the financial product market still has little in the way of cost-effective annuity and insurance products to assist self-funded retirees manage longevity risk. Both the Henry tax review and the Cooper superannuation review have drawn attention to this structural weakness in the financial product market.

> ***<u>Recommendation:</u>***
> ***The inquiry should identify regulatory and other impediments to the development of products that can better insure retirees against longevity risk - including the mandatory***

minimum annual withdrawal requirements for superannuation pensions - and should recommend urgent action to address these impediments.

Impediments to converting non-super assets to income

If part of the wealth that many older Australians have tied up in other assets – both financial assets and the family home – could be converted to an income stream, this could finance a more comfortable retirement while at the same time mitigating some of the financial risks associated with market linked superannuation investments.

However, a number of impediments – particularly to downsizing the family home - would need to be overcome to make this a viable option. While home ownership confers many other benefits and protections in old age and there should be no compulsion for older Australians to draw on the equity in their homes to supplement retirement incomes, nor should there be unreasonable impediments to them doing so.

Recommendations:
The inquiry should investigate the costs and benefits to the Commonwealth of exempting equity from sale of an age pensioner's family home from the age pension assets test, and the states and territories providing a one-off exemption from land transfer duty on the purchase of a cheaper residence using the balance of the sale proceeds, provided the equity thereby released is invested in eligible retirement income producing products. This investigation should include an assessment of the effectiveness, costs and benefits of the ACT Pensioner Duty Concession Scheme in place since 2008.

The inquiry should also assess the wider economic and social benefits of removing these impediments to downsizing - including better matching of existing housing stock to household needs and improved housing affordability.

Lifting the quality and independence of financial advice

The growing emphasis of Australian retirement incomes policy on self-provision through both mandatory superannuation and voluntary savings means that individual Australians now have greater responsibility for managing their finances to see them through retirement.

Despite recent efforts to improve financial literacy, many Australians have a poor grasp of even basic financial concepts. Even those who are relatively knowledgeable find it difficult to navigate the complexity of today's market for financial products and services.

This places a growing number of households – particularly those already retired or approaching retirement – in the situation of having to depend on professional financial planners and advisers to manage their affairs.

While recent reforms have targeted the integrity of the financial advice sector, problems of quality and conflict of interest persist.

Recommendations:
The Inquiry should consider how best to lift the quality and integrity of the financial advice sector including: whether conflicted remuneration and percentage fees should be allowed; whether minimum educational standards for financial advisers should be lifted; and whether the tougher of the APES 230 financial advice standards should be adopted by ASIC as a licensing requirement for financial advisers.

The inquiry should also consider what can be done to improve financial awareness (as distinct from literacy) to help people navigate the system, understand who does what and whom they can trust.

Managing impacts of technological change

For older Australians, the rapid pace of technological innovation in the financial system has been a mixed blessing – beneficial for those who have access to the necessary facilities and command the necessary skills and resources to utilize new devices and on-line services, but risking exclusion for those without.

Australians in older age cohorts are the least likely to have access to or use the internet. National Seniors research also shows that older people are particularly concerned about personal safety, privacy and security. As a result, many value the personal face to face interaction of over the counter banking and may consider on-line banking less safe.

Although internet use among older Australians is growing, and will continue to do so as younger cohorts age, there remains an ongoing risk that successive older generations will be excluded from financial services employing the most recent technologies.

<u>Recommendations</u>

In considering the impacts of technological innovation, the Inquiry should examine how best to ensure the safety and security of on-line financial services. While this is critical for all age groups, older Australians are more highly attuned to risks associated with on-line services and may therefore be less likely to benefit from internet based technological advances.

The inquiry should also consider how to improve access for older Australians to the internet and to mobile devices so that they might share in the benefits offered by these technologies.

The inquiry should consider whether additional protections should be included - possibly in an industry code of conduct - to ensure that when financial institutions and providers plan to 'shut down' services that do not rely on the internet or contemporary ICT technologies, due care is taken to avoid excluding, marginalising or disempowering those who with limited access to or ability to utilise these technologies.

3 Major developments since earlier inquiries

Far-reaching changes have occurred in Australia's financial services system since the deregulatory reforms that followed the 1979 Campbell inquiry (Commonwealth of Australia 1981) and the regulatory framework was overhauled on the recommendations of the 1997 Wallis inquiry (Commonwealth of Australia 1997).

Undoubtedly the financial liberalisation that followed those earlier inquiries has been a key driver of change, removing many regulatory impediments to innovation while simultaneously opening up the system to greater competition to drive greater efficiency, increase choice and lower costs.

In addition, significant structural trends and technological developments have accelerated growth and change in the financial system since the last comprehensive review. The following discusses the most significant of those developments.

3.1 Global integration

Greater integration with global financial markets has brought significant economic benefits. By opening new markets for Australian financial institutions and services, exposing domestic services to greater international competition and enabling more direct access to global capital markets, global integration has been a significant source of increased efficiency and growth, both in Australia's financial system and in the wider economy.

At the same time, greater financial integration with the rest of the world has exposed Australia's economy, businesses and households to greater risk of contagion from financial instability and made us more susceptible to regulatory failures elsewhere in the world, as the Global Financial Crisis (GFC) so dramatically revealed. It also means that the regulation of Australia's financial system cannot be allowed to fall significantly out of step with leading financial centres without damaging Australia's competitiveness in attracting international investment and in exporting financial services.

3.2 Technological innovation

Changes in information and communication technologies have transformed the nature of financial institutions and products, revolutionising distribution platforms, giving rise to a wide range of new financial products and instruments and vastly increasing the speed and volume of financial transactions.

Technological innovation has also been a force for change in the structure and composition of the industry. Developments in mobile devices and applications, peer-to-peer payment and lending services and the emerging 'digital wallet' are all enabling new players – from internet providers and mobile device companies to supermarket chains – to enter into direct competition with the banking sector for payment and lending services.

While the role of technology as a force for ongoing change in financial markets and products was foreshadowed at the time of the Wallis Inquiry, few could have anticipated at the time just how transformative these changes would prove to be, particularly since the development of mobile devices from the mid-2000s.

The internet has been a key enabler of this revolution, providing instantaneous access to global markets, facilitating globalisation of the financial services supply chain and supporting a wide range of on-line banking and payment platforms, mobile device applications, information, advice and investment services.

Consumers have clearly benefited from technological advances in financial services by way of increased choice, reduced cost and greater convenience. Technological innovation has given rise to increased efficiency and choice, with a much greater diversity of financial products and services now available to suit a wider variety of consumer needs and preferences.

Yet those without access to the internet or who are unable or reluctant to adapt to new mobile devices and applications are at increased risk of exclusion. This includes many older Australians, particularly those in rural and remote areas where internet access and the availability of associated products and services are restricted.

Not only do different age cohorts have varying abilities to embrace new technologies, many older Australians also experience a higher degree of concern about the safety and security of on-line banking and payment systems.

3.3 Growth of superannuation sector

Rapid growth in the superannuation sector has been progressively shifting the centre of gravity of Australia's financial system away from the banking sector and towards superannuation funds.

With $1.8 trillion in funds under management at December 2013 (Australian Prudential Regulatory Authority 2014), compared to just $245 billion in 1996, the superannuation industry represents the second largest source of growth in the Australian financial system after capital market (ASX) trading (Maddock 2013). By 2035, the Cooper review (Commonwealth of Australia 2010) projected Australians would have increased their collective super savings to $6.1 trillion in nominal dollars. This equates to $3.2 trillion in real terms, roughly equivalent to the assets of the banking sector today.

Ongoing growth of superannuation assets will have profound implications for the future of the financial system and for the economy as a whole. As superannuation funds become an increasingly important source of domestic savings, asset allocation decisions by superannuation fund managers will become increasingly influential in shaping domestic investment.

It is imperative that the long term interests of fund members remain the sole purpose of superannuation funds. The Murray inquiry should consider increasing safeguards to prevent superannuation funds being directed towards investments designed to promote other purposes, such as particular national or sectoral growth objectives.

The growing significance of superannuation in household asset holdings also has profound implications for how financial risk is allocated within the economy, with a rising proportion of households exposed to financial risk through market linked investments.

In 2010, 82 per cent of all households held some superannuation, up from 76 per cent in 2002, with the mean value across all households of superannuation assets being $142,429 in 2010 (Wilkins R (ed) 2013). As the superannuation guarantee scheme matures, both the average value and the proportion of household assets held in the form of superannuation will continue to grow.

This transfer of risk to individuals and households has major implications for older Australians.

3.4 Population ageing and rising wealth

Population ageing and rising household wealth have together driven strong growth in demand for financial services, particularly for funds management, financial planning and advice.

The period from 2002 to 2010 saw particularly strong growth in household wealth in Australia, increasing by an average of 38 per cent across all households. While the family home is the most important asset, followed by other property, superannuation is the most important financial asset and has increased at the expense of equity investments and other assets such as life insurance.

Those in the 55-64 year age range experienced the largest growth in net worth over the decade. For this age group, between 2002 and 2010 median net household wealth rose by 54 per cent to $847,349 through the combined effect of rising home values and growth in superannuation assets (Wilkins R (ed) 2013). (Older Australians who do not own a home or who have not benefited from superannuation savings have not shared in this increase in average wealth and have become relatively more disadvantaged as a result.)

While research cited by ASIC suggests a majority of Australians have never used a financial planner (Australian Securities and Investment Commission 2011), the probability of doing so appears to rise as people approach retirement age. National Seniors research suggests up to 71 per cent of Australians aged 50 and over who hold superannuation assets have obtained professional advice on how to invest their superannuation (National Seniors Productive Ageing Centre 2012).

As the population ages, and the proportion of the population with superannuation assets rises, the demand for funds management and advisory services will also rise. By 2060 the proportion of Australians aged 65 years or more is projected to increase from one in seven to one in four. Strongest growth will occur in the oldest age groups, with the number aged over 75 years projected to increase by 4 million from 6.4 to 14.4 per cent of the population by 2060.

3.5 Growth in household exposure to financial risk

One of the more disturbing developments to have occurred since the current financial regulatory architecture was put in place is the growth in households' exposure to financial risk. This is largely being driven by a retirement incomes policy that relies on a combination of compulsory and voluntary superannuation savings to shift Australians progressively towards greater self-reliance in older age. As a result, an increasing proportion of the assets of older households are in superannuation or direct equity holdings. In 2010, 55 to 74 year olds held around 30 per cent of their total assets in equities, trusts or superannuation funds exposed to movements in financial market prices and not subject to any depositor protection (Wilkins R (ed) 2013).

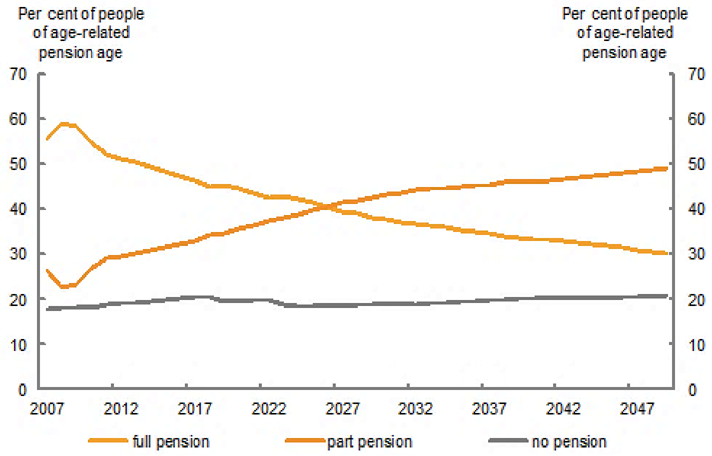
Although currently a majority of retired Australians remain fully or partially dependent on the age pension, as the Superannuation Guarantee Scheme matures a growing proportion of older Australians will be fully or partially reliant on superannuation savings to fund their retirement. The Henry Tax Review (Commonwealth of Australia 2010) projected the proportion of eligible Australians on a full age pension would fall from around 60 per cent in 2010 to 30 per cent by 2050, while the proportion receiving a part pension supplemented by superannuation and voluntary savings would rise from around 25 per cent to almost half of all retirees by 2050 (Figure 3.1). Notably, these projections did not take into account the planned increase in the superannuation guarantee from 9 per cent to 12 per cent. While this increase has been deferred for the time being, when and if it does proceed the replacement of age pensions with part pensions and private savings will occur more rapidly than shown in Figure 3.1.

From a financial system point of view, this amounts to a substantial reallocation of financial risk from government and financial institutions to individuals and households 1. This increased risk exposure has two dimensions:

- first, greater individual exposure to <u>market</u> risk is occurring as savings shift from cash and deposits to market-linked superannuation investments; and
- second, households, rather than governments and financial institutions, are increasingly exposed to <u>longevity</u> risk and the possibility of outliving their savings.

[1] As evidenced by the GFC's more severe impact on household balance sheets than on those of Australian financial institutions.

Figure 3.1
Proportion of eligible age receiving full, part or no pension



Source:(Commonwealth of Australia 2010)

The greater burden of financial and longevity risk now being borne by older Australians also exposes them to other sources of risk, including:

- The risk that inflation will deplete savings and investments - the number one concern of two-thirds of senior Australians;
- Risks of poor investment decisions due to low levels of financial literacy, lack of access to, or poor quality financial advice;
- For owners of self-managed superannuation funds, looming management risks associated with increasing frailty and cognitive decline in old age; and
- Heightened stakes where investors are duped by fraudulent or unethical market players.

Although a number of these risks were identified at the time of the Wallis inquiry, their system-wide implications would appear to have been underestimated.

3.6 Growing complexity

Increasing complexity has made it more difficult for individuals to navigate the financial system without assistance, bringing additional costs and risks for consumers.

Financial innovation has contributed to complexity, reducing transparency and heightening risks of systemic failure due to incomplete information on risk. As the GFC revealed, some financial innovations have been anything but transparent, with more complex financial products so opaque that even sophisticated credit rating agencies and financial institutions could not readily understand them.

Another source of complexity has been the changing structure of the financial sector as traditional financial institutions diversify their business models in response to changing market conditions. With banks and insurance companies moving into funds management and the delivery of financial planning and advice, vertical integration of financial advisory services with financial product suppliers has made it more difficult for the uninitiated to know what affiliations their financial advisers may have or whom they can trust.

Greater complexity is also arising from growing interdependencies between superannuation, the age pension and the tax system. The interplay between these systems is further complicated by frequent changes of policy and regulation.

The inquiry should consider how to better protect ill-informed consumers who, in managing their financial affairs, are increasingly being made reliant on professional advice to navigate complex systems and products.

Whenever a change is proposed to either taxation, social security, superannuation, life insurance or aged care arrangements, at either federal or state level, the associated regulatory impact statement should consider the implications for each of the other policy areas listed.

3.7 Financial System Failures

The post-Wallis era has also been marked by significant financial failures that have tested the resilience of Australia's financial system.

3.7.1 The Global Financial Crisis

Unquestionably, the event that has subjected the post-Wallis financial system to its biggest test was the Global Financial Crisis.

Compared to other developed economies, Australia withstood the contagion associated with the crisis remarkably well. It is generally conceded that this was at least in part due to the strength and profitability of Australia's banking system and strong prudential regulation of financial institutions, which meant lending standards were not compromised to the same extent as elsewhere. Together with a strong economic and fiscal position and tight monetary policy settings at the time, these financial system strengths placed Australia in a better position than many developed economies to mount a strong defence and avoid some of the worst effects of the crisis.

On the impact of the GFC…

Currently I am going through the turmoil of having to try and remain a self-funded retiree after having lost $350,000 as a result of the World Economic Downturn. Went back to work and of course at 69 I was then made ineligible for Employer Tax Contribution although I was still able to Contribute to super until 74.

– National Seniors member (2011)

Even so, Australian financial institutions could not escape the consequences of the global loss of confidence in the banking system and the drying up of global capital markets. It proved necessary for the Reserve Bank to increase liquidity and for taxpayers to guarantee deposits held by Australian banks and other deposit-taking institutions to avert a potential run on deposits, breaching a key tenet of the Wallis reforms that bank deposits should never be underwritten by government. Thus, although Australia's relative resilience to the GFC suggests that past financial reforms have generally served the country well, the crisis has prompted a fundamental rethinking of the laissez-faire philosophy underpinning financial market regulation.

The crisis also highlighted how heavily exposed Australia's superannuation sector was to financial markets, with many older Australians fully or partially reliant on superannuation or direct equity investments for their retirement income suffering significant capital losses. While for Australia as a whole, real net wealth per household fell by an estimated 14 per cent in 2008 – the largest fall recorded since the inception of the ABS household wealth survey – household superannuation assets declined 23 per cent and direct equity investments by as much as 47 per cent. While those still in the accumulation phase may have time to recover these losses, those already retired and drawing their superannuation pensions may never do so, their prospects of even a modestly comfortable retirement greatly reduced as a consequence.

3.7.2 Other significant events

A string of home grown financial failures have also tested Australia's regulatory framework and imposed even larger losses on some investors. While APRA strengthened its prudential supervision of financial institutions in the wake of the first of these events – the collapse of HIH in 2002 - this did not prevent small investors being burned by subsequent institutional failures – including Westpoint (2006), Storm Financial (2009), Trio/Astarra[2] (2009) and Banksia (2012). These failures point to ongoing weaknesses in Australia's financial and prudential regulatory framework, particularly for protecting financially unsophisticated consumers from high risk investment strategies[3].

[2] A Parliamentary Joint Committee on Corporations and Financial Services inquiry concluded that the collapse of Trio/Astarra was more troubling even than the collapse of Storm Financial because, whereas Storm Financial involved Australian investors being persuaded to put their money into investment vehicles which were much higher risk than was appropriate, Trio Capital had actually involved fraud. A key finding of Committee was that checks and balances in the Australian financial and superannuation system did not work to identify the existence of fraudulent conduct as it was left to an industry participant to alert regulators to the situation.

[3] While an 'íf not why not' prudential benchmarking regime was introduced by ASIC in relation to non-bank lenders in the wake of the Westpoint collapse, firms failing to comply face little in the way of sanctions.

4 Key Issues for senior Australians

While significant developments since the Wallis inquiry raise issues for many aspects of Australia's financial system, the balance of this submission focuses on key issues for senior Australians. These are grouped into the following six broad themes:

i. Balancing financial system objectives of efficiency, safety and stability;

ii. Managing growing individual exposure to financial risk;

iii. Addressing longevity risk;

iv. Removing impediments to converting non-superannuation assets into income;

v. Lifting the quality and independence of financial advice; and

vi. Managing impacts of technological change.

4.1 Balancing financial system objectives

As for previous comprehensive reviews of Australia's financial system, a critical task for the Murray inquiry will be to strike an appropriate balance between the three, competing system objectives of:

- Efficiency
- Safety, and
- Stability

It is accepted that trade-offs between these objectives are unavoidable. Assuring the safety of financial products and services from the point of view of end users by setting minimum standards or proscribing certain conduct will inevitably involve some loss of efficiency. Similarly, strategies to protect the stability of the system may dampen commercial incentives or distort competition, again at some cost to efficiency. Getting this difficult balance right requires protection for consumers and safeguards against system instability to be effective, yet without unduly suppressing incentives that drive efficiency.

A key philosophical underpinning of reforms that followed the Campbell and Wallis inquiries was a belief that markets drive efficiency and that regulatory intervention in financial markets should be kept to a minimum. The deregulatory reforms of the 1980s were thus largely driven by efficiency considerations. Similarly, the restructuring of the regulatory framework recommended by the Wallis inquiry reflected a view that safety and stability concerns were most likely to arise in financial institutions, and that financial markets could be regulated more lightly to promote maximum efficiency. This was subsequently embedded in the institutional separation of prudential regulation of financial institutions – with its focus on safety and stability - from regulation of financial markets, with an emphasis on efficiency and relying mainly on disclosure, education and advice to ensure integrity and protect consumers (Davis 2011).

In many respects the reforms introduced following the Campbell and Wallis inquiries have served Australia well. Deregulation of interest and exchange rates and the entry of foreign banks during the 1980s increased competition and innovation, improved access to finance at lower cost and delivered a diversity of new financial products and services to increase consumer choice (Commonwealth of

Australia 1997, Edey 2013). The subsequent establishment of APRA as the stand-alone prudential regulator of financial institutions and ASIC as the corporate, markets and financial services regulator, focused on efficiency – is generally considered to have contributed to the strength and stability of Australia's financial system during the Global Financial Crisis.

On the other hand, the events leading up to the GFC showed that the light-handed approach to financial system regulation had placed too much faith in the unfettered operation of markets to deliver efficient outcomes without compromising system stability. Closer to home, severe losses experienced by individual savers and investors as a result of the collapse of local financial institutions and schemes also pointed to systemic weaknesses in assuring the safety of financial products and services, including inadequate compliance monitoring and enforcement by regulators.

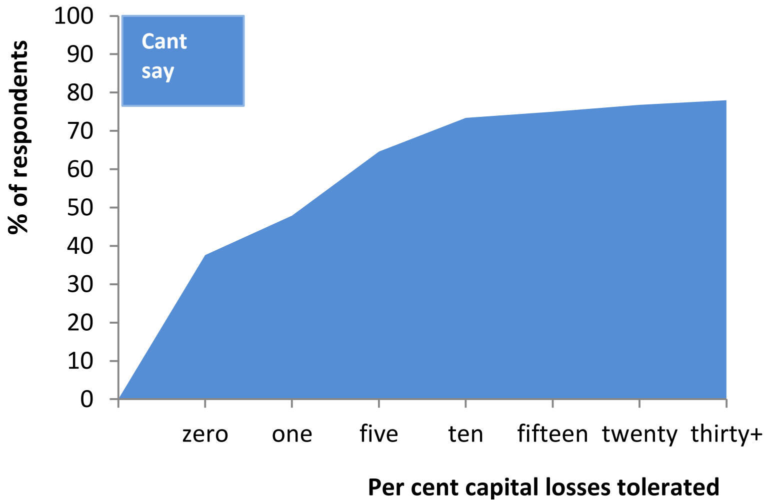
4.1.1 Balancing stability and efficiency

National Seniors supports the view that a key lesson from these events is the need for some rebalancing of the system of financial regulation towards greater system stability and safety for end users (FINSIA 2009, Davis 2011).

As a significant and growing group of financial service consumers, older Australians have a low appetite for risk, with the vast majority revealing a clear preference for certainty and reliability over higher returns from investments.

Asked about the largest loss in retirement savings they would tolerate over one year having regard to their long-term goals for retirement, the vast majority of those aged 50 or older express a clear preference for stability over return. Almost 38 per cent said they would not tolerate <u>any</u> loss in their retirement savings over a one-year period. And while some did not quantify a response, only 13 per cent of those who responded to this question said they would tolerate a loss more than 5 per cent in any one year (Figure 4.1).

Figure 4.1
Senior Australians' tolerance for capital losses



Source:(National Seniors Productive Ageing Centre 2013)

Bank deposit insurance schemes are a mechanism employed in a number of other jurisdictions for improving financial stability. Although Australia did not have such a scheme in place prior to the GFC, a Financial Claims Scheme (FCS) was introduced subsequently in recognition of the implicit government guarantee of deposits in financial institutions considered 'too big to fail'. Unlike deposit insurance schemes elsewhere in the world, the FCS does not require insured institutions to pay an up-front premium, but instead provides for APRA to pursue ex-post recovery of claims.

An issue for the Murray Inquiry will be whether this scheme has adversely affected competition between banks and non-bank financial institutions (Davis and Jenkinson 2013).

Maintaining a healthy degree of competition within the financial system offers the best prospect of fostering innovation, providing choice and keeping downward pressure on costs to consumers. This requires a system that is open to new entrants and a regulatory framework that ensures a level playing field – including competitively neutral treatment of organisations providing competing products[4].

On the other hand there will always be a need for some safeguards against the risk that unfettered competition may encourage unacceptably risky or unethical behaviour. In addition, as the GFC confirmed, there is a need to protect individual depositors against systemic risks that could wipe out their savings.

Many older Australians hold their savings in bank deposits - whether as insurance against rainy day events or because they believe this is the only sure way of guaranteeing the safety of their savings.

The Financial Claims Scheme appears to offer an effective way of protecting depositors against systemic risk and should be retained in some form.

To achieve a better balance of safety, stability and efficiency considerations, the inquiry should consider how best to address competition concerns, including whether an up-front fee would assist in offsetting any competitive advantage enjoyed by institutions covered by the scheme.

4.1.2 Balancing safety and efficiency

While Australia has already taken steps to strengthen prudential regulation of financial institutions in the wake of the GFC, the philosophy of light handed disclosure regulation still underpins much of the regulation of financial markets and financial advisers. Yet the evidence of a series of subsequent domestic financial failures suggests disclosure, education and advice alone are insufficient to protect consumers in an increasingly complex financial system.

The Future of Financial Advice (FOFA) reforms went some way towards addressing this gap by, among other measures, banning commissions being paid by financial product providers to advisers (conflicted remuneration) and introducing a new requirement for financial advisers to have an explicit fiduciary duty to their clients. (Notably, some felt even these changes did not go far enough to address conflict of interest in the delivery of financial advisory services (Valentine 2013)).

It is therefore of considerable concern that the new Coalition government continues to propose amendments to wind back some of the core consumer protections contained in the FOFA reforms.

While regulation should be proportionate to the risks involved and compliance costs kept as low as possible to minimise adverse impacts on efficiency and affordability, the costs of consumer protection regulation need to be judged against the risks. As the institutional failures of the past decade have clearly demonstrated, the risks to individual investors of conflicted or poor quality advice can be very high indeed.

Individual investors need genuinely independent advice on how to navigate an increasingly complex system and understand the choices facing them. It is simply too much to expect the unsophisticated

[4] For example, while exemption of insurance businesses from competition laws, discrimination legislation etc. may be justified on actuarial risk grounds in relation to insurance products, the justification for such exemptions needs to be re-examined as the insurance sector extends into other products and services in competition with other businesses that do not enjoy the same exemption.

investor to know whom to trust in the current environment. Not only should conflicted remuneration and percentage commissions be prohibited, there must be relevant and enforceable safeguards surrounding disclosure and a stronger emphasis on compliance and enforcement if a repeat of past financial failures is to be avoided. In addition, fundamental conflicts of interest inherent in the vertical integration of financial advisory services with financial product suppliers need to be tackled.

In considering how best to balance safety and efficiency considerations, the Inquiry should consider how conflict of interest in the financial advice sector can be effectively eliminated while vertical integration of financial product suppliers with financial planning and advisory services is permitted.

4.2 Growing individual exposure to market risk

A critical issue for older Australians is their growing exposure to market risk as superannuation savings replace government pensions.

Under current policy settings, mandatory superannuation arrangements will ultimately expose most Australians to market risk. Those who are retired or approaching retirement are particularly vulnerable to risks associated with market-linked investments because their investment horizon is shorter and, '*… in the post-retirement phase ….there is usually no or limited ability to offset poor returns with higher contributions or other income'* (Commonwealth of Australia 2010).

The exposure of superannuation fund members to market risk was thrown into high relief at the time of the GFC, when large capital losses were experienced by many self-funded retirees. Around half of all member assets at the time were in so-called 'balanced' default options, where as much as 60 per cent to 80 per cent could be invested in growth assets such as shares and property. In 2008, Australian superannuation funds had the highest allocation towards equities with an average equity allocation of 57 per cent, compared to an OECD average of 36 per cent. As a result, Australian superannuation funds posted one of the worst results among 30 OECD countries, with total superannuation assets falling by 18.2 per cent between December 2007 and March 2009. This exposure to equities was by no means restricted to the accumulation phase of retirement savings, with the median account-based pension fund reporting a return of minus 19.8 per cent over the 12 months to March 2009 (Bateman 2009)(20).

Despite the lessons of the GFC, Australian superannuation funds continue to be heavily exposed to market risk, with 54 per cent of investments allocated to equities in 2012 compared with 52 per cent in the US, 43 per cent in Canada, 35 per cent in Japan and just 27 per cent in the Netherlands, according to the 2013 Towers Watson Global Pension Assets Study.

The favoured tax treatment of equities vis-a-vis other asset classes may be one factor encouraging superannuation members to favour riskier asset classes. While income earned on cash or fixed-interest investments, including bonds, is taxed at an individual's marginal tax rate and receives no capital gains tax discount, sales of equities held for more than 12 months receive a 50 per cent discount on capital gains.

The potential for retired Australians to suffer large capital losses from exposure to market-linked superannuation investments points to the need for additional protections to guarantee at least the preservation of members' contributed capital plus interest.

As well as the risk of capital losses due to volatility in asset prices, retirees are exposed to the risk that their superannuation investments will not be the best choice from an income-generating point of view. Ultimately, what matters in retirement is not the value of an asset but the income stream that it yields. However, the income-generating performance of superannuation fund investments is obscured by the practice of bundling asset and income into a single unit price. There should be a requirement for funds managers to report separately on returns of both the asset and the income generated by that asset so that fund members are better informed of the implications of their asset choices.

Consideration could be given to requiring trustees to direct investment strategies in the pension phase towards annuities and other more secure income yielding investments. However, while this approach has been adopted in some other jurisdictions (the US and UK, for example), and some Australian funds have also implemented the practice, the Cooper superannuation review did not favour compulsion, noting that: '*In countries with compulsory annuitisation, members of defined contribution schemes can be locked into lower income streams if markets fall shortly before their retirement as the value of the annuity is based on the value of their lump sum and market conditions on retirement day*' (Commonwealth of Australia 2010)(Vol 2, 196). Being based on life expectancy, annuities could also increase longevity risk in some cases, and additional safeguards would be required to protect consumers, such as requiring annuities to be held in separate trust funds that could not be taken to pay insurer's creditors.

Poor management of market risks also raises questions about incentives, practices and capabilities in the fund management sector. For example:

- are trustees sufficiently focused on the key task of generating secure retirement incomes that rise broadly in line with inflation, as distinct from maximizing short term returns?
- do funds managers face incentives to take on more risk than would align with the interests of members?[5]
- are trustees fully cognizant of the implications of volatility risk and sequence risk for individual fund members and sufficiently focused on managing these risks?
- are superannuation pricing practices, which aggregate assets and income into a single unit price, obscuring the true risk profile of members' investments?

From the perspective of the financial system as a whole, increased individual risk exposures associated with growth in superannuation raises the broader question as to whether the prudential regulatory framework for Australia's financial institutions is appropriately focused on where risks are most heavily concentrated. Whereas the primary focus of the prudential and consumer protection regimes have to now been on the safety of deposits in deposit-taking institutions, growth in superannuation funds and the associated transfer of risks from institutions to individuals has arguably shifted the balance of safety and stability risks more towards funds management and the provision of financial advice. This includes risks associated with the rising incidence of white collar crime.

The Inquiry should consider how best to address growing individual exposure to market risk, including:

Are current arrangements for the safety and stability of the financial system as a whole still targeted to where risk is most concentrated?

Do current arrangements for the governance and prudential oversight of superannuation funds adequately address the growing exposure of households – and particularly retirees - to financial risk?

[5] Where fund managers receive larger commission as asset values rise, while downside risks rest with individual investors, there will be incentives for fund managers to take more risks.

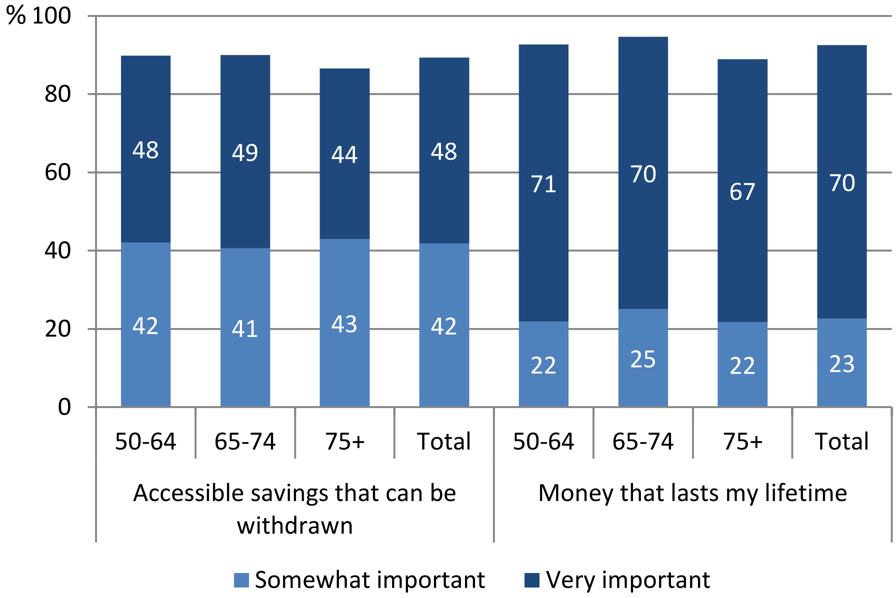
***Should APRA direct the funds management sector to separate income and capital unit prices in order to increase transparency regarding the risk profile of investment options*?**

Should superannuation trustees be encouraged to direct investment strategies in the pension phase towards annuities and other more secure income yielding investments?

4.3 Addressing longevity risk

Longevity risk refers to the possibility that retirees will outlive their savings. This is the most significant risk facing retirees, and is ranked as of high importance by more than three-quarters of older Australians surveyed by National Seniors (see Figure 4.2).

Figure 4.2
Importance in retirement of: accessible savings/money that lasts my lifetime



Source: (National Seniors Productive Ageing Centre 2013)

While the Wallis inquiry did foreshadow this issue, life expectancy has risen sharply since that time, adding to longevity risk for both current and future retirees.

In 2002, Treasury's *Intergenerational Report* (Commonwealth of Australia 2002) projected life expectancy at birth to be 82.5 years for males and 87.5 for females in 2042. Eight years later, the 2010 *Intergenerational Report* (Commonwealth of Australia 2010) projected life expectancy at birth to be 86.1 years for males and 89.2 years for females in 2040, representing a large increase, especially for males.

Employing a different approach to demographic projections than used by either Treasury or the ABS, a recent Productivity Commission report highlights the risk that longevity will be even greater than previously thought. Their study forecasts that a girl born in 2012 will live for around 94.4 years (and 91.6 years for a boy) - much longer than estimated by Treasury and the ABS.

> '*Using current period life expectancies, it might appear that a person born in 2012 could expect to live for 19 more years after they reach 65 years old. In fact, it is projected that they will live for around 29 years after that age*.'(Productivity Commission 2013)

Noting that Australians have one of the longest life expectancies in the world, the Henry tax review acknowledged that the numbers of people living longer than average life expectancy was growing very rapidly and would continue to do so. An accelerating rate of decline in mortality rates is the main driver of increasing longevity risk for retirees, with every one year increase in life expectancy estimated to increase the savings requirement at retirement by between 9 and 13 per cent (Rice Warner 2012).

Quite apart from the challenges posed by growing average longevity, uncertainty arising from the high degree of individual variability in age of death makes it exceedingly difficult for retirees to manage their assets to last throughout their lifetime.

In this context it remains a matter of concern that the financial product market still has little in the way of cost-effective annuity and insurance products to assist self-funded retirees manage longevity risk. While life time annuity products are available, take-up is low due to their perceived poor return on investment. The Association of Superannuation Funds of Australia (ASFA) estimates that a couple looking to achieve a comfortable retirement needs around $57,665 a year, while those seeking a 'modest' retirement lifestyle need $33,358 a year. According to Challenger Ltd's lifetime annuity calculator, a couple commencing a lifetime annuity at 65 would require an investment of the order of $775,000 to be assured of even the more modest lifestyle on an inflation-protected basis, while those seeking a more comfortable retirement would require an up-front investment of the order of $1.34 million.

This gap in the financial product market was a key finding of the Henry tax review:

> *'The lack of products that retirees can purchase to insure against longevity risk is a structural weakness in the system. Better retirement income products should be available for purchase so a person can ensure an income higher than the Age Pension through their retirement'* (Commonwealth of Australia 2010).

Prescriptive rules to restrict earnings tax exemptions on superannuation pensions to products that deliver a genuine income stream were identified by both the Henry and Cooper reviews as impeding the development of products that would better insure retirees against longevity risk.

In particular the rule requiring minimum annual withdrawals to be made from a pension every year urgently requires review:

- First, because minimum annual payments prescribed under the rule would appear to be based on outdated actuarial calculations and probabilities, as implied in the Productivity Commission projections outlined above; and

- Second, because the minimum annual withdrawal requirement prevents the development of products that defer payment of an income stream – yet this is one of the few options available to retirees to better manage longevity risk.

National Seniors also supports the recommendation of the Henry review that the government consider issuing more long-dated bonds to assist in the management of investment risks associated with products designed to insure against longevity risk. In this regard it is noted that the allocation to bonds by pension funds in other OECD countries is significantly greater than is the case in Australian superannuation funds. While more overseas pension funds are defined benefit schemes, whereas in Australia defined contribution funds now predominate, the aim of both should be to provide for adequate protection against inflation.

Direct investment in bonds – both government and corporate – can also improve the individual retail investors' ability to smooth returns over time as a way of managing sequence risk. However, retail investors have only limited access to corporate bonds in Australia.

A further impediment to the development of products to better insure retirees against longevity risk are the high capital adequacy requirements that APRA imposes on providers of annuity products. These prudential requirements need review as current regulatory hurdles have left the market with just one provider. The lack of competition in this market means there is little choice for consumers and no pressure to innovate or develop more affordable products.

A lack of demand for annuity products from superannuation funds may also be a factor in the under-development of this market. To the extent that fund managers are overly focused on short term performance metrics rather than on their core task of generating a secure income stream for members in retirement, there may be insufficient institutional demand to foster a more competitive market for the supply of secure income-yielding products.

Reducing fees associated with the management of funds for allocated pensions – including action to minimise fee-generating churning - would also help extend the life of retirees' savings as a further protection against longevity risk. As the Cooper review acknowledged: '*Fees and costs matter; they detract from members' retirement savings and need to be managed as diligently as the generation of investment returns* (Commonwealth of Australia 2010) (Vol 1, 4)

The inquiry should identify regulatory and other impediments to the development of products that can better insure retirees against longevity risk - including the mandatory minimum annual withdrawal requirements for superannuation pensions - and should recommend urgent action to address these impediments.

4.3.1 Reliance on age pension to mitigate retirement risks

While it is true that the availability of the age pension provides an ultimate safeguard against both investment and longevity risk, retirement incomes policy in Australia is increasingly predicated on the availability of a combination of compulsory superannuation and voluntary savings to supplement the age pension in order to provide adequate retirement incomes. This policy is expected to gradually reduce the proportion of retirees fully reliant on the pension, with the proportion supported by a combination of part pension supplemented by superannuation and voluntary savings rising from 25 per cent in 2010 to around 50 per cent by 2050. In this context, relying on the age pension to mitigate risks associated with superannuation investments is unlikely to be either politically or fiscally sustainable.

In short, if the retirement income system is to achieve its aim of making older Australians more financially independent, there must be action to address current impediments to the management of both market and longevity risk for both current and future superannuation fund members.

Australia's retirement income arrangements are also predicated on the assumption that retirement savers will be able and willing to make informed and appropriate retirement saving choices throughout their life – an assumption that has been strongly challenged:

> '*… superannuation fund members are required to make crucial decisions throughout both the accumulation and decumulation phases of retirement saving including - whether and how much to contribute? Which superannuation fund? Which investment option(s)? When to retire? And which retirement benefit? Throughout this process individual retirement savers must keep track of possibly numerous superannuation accounts as they move in and out of the workforce and between jobs…. The track record of Australian retirement savers' ability to engage in this important decision making is poor*.' (Bateman 2009)(19-20)

4.4 Impediments to converting non-super assets into income

In 2010 the median net household wealth of 55-64 year olds was $847,349 and for those over 65, $568,256 compared to just under $400,000 for the population as a whole. The largest component of household wealth is the family home. More than 80 per cent of Australians aged 55 and over own their own homes and, over the decade to 2010, the median value of Australian homes rose by 86 per cent from $259,000 to $482,000 (Wilkins R (ed) 2013).

If wealth that some older Australians have tied up in other assets - both financial assets and the family home - could be converted to an income-stream - this could finance a more comfortable retirement while also mitigating some of the financial risks associated with market linked superannuation investments. However, a number of impediments would need to be overcome to make this a viable option.

Firstly, home ownership confers many other benefits that must be weighed up when considering such a decision. For many households home ownership is critical to avoid housing related poverty in old age, when incomes are low. Equity in the family home also provides insurance against rising health care costs. Over 70 per cent of Australians aged 50 and over in 2012 identified being able to cover aged care or medical costs as among the most important risk to manage in older age. Others may be reluctant to draw on home equity out of a desire to pass on the family assets intact. Although preserving their estate for the next generation is a significant consideration for only a minority of older Australians (National Seniors Productive Ageing Centre 2012), those whose family home is part of a farm business may be particularly concerned about the consequences of selling and may hang on to farm assets against their own best interests.

Given the many ways in which home ownership provides economic and financial protection in older age, there should be no compulsion for older Australians to draw on the equity in their homes to supplement their incomes. On the other hand, nor should there be unreasonable policy or regulatory impediments to them doing so[6].

For those about to or already retired, the two main options for converting home equity into an income stream are:

- home equity conversion loans (reverse mortgages) which do not need to be repaid until the property is sold; or

- downsizing to a cheaper dwelling.

The take-up of home equity conversion loans has been very low to date (Dolan, McLean et al. 2005) possibly due to home owners' fear of outliving their remaining equity, although some providers assume this risk by providing for recovery of loans from the estate upon death of the home owner.

Table 4.1
Percent considering moving to a smaller residence in future

	50-64	65-74	75+	Total
Yes	33.9	28.7	15.9	29.7
No	51.6	58.4	70.7	56.3
Can't say	14.5	12.9	13.3	14.0
Total	100.0	100.0	100.0	100.0

Source: (National Seniors Australia 2013)

[6] Of course there are also non regulatory impediments to downsizing for older Australians, including a lack of appropriate housing stock and the risk of losing proximity to family, friends, the family doctor and so on.

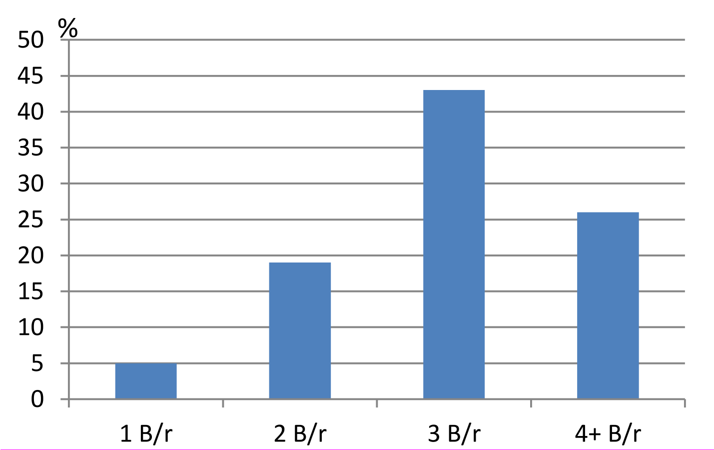
Downsizing represents a lower risk option, although trading down is rare. As shown in Table 4.1, less than 30 per cent of those 50 and over are considering moving to a smaller house in the future according to National Seniors Social Survey 2013, and this proportion declines as age increases.

Even so, many older Australians occupy larger houses than they really need.

Three quarters of those aged 60 or more currently occupy a home containing 3 or more bedrooms, with just 19 per cent in 2-bedroom and 5 per cent in 1-bedroom homes (Figure 4.3). Yet a quarter of 55-64 year olds and almost two-thirds of those 85 and over live in single person households. As shown in Figure 4.4, more than half single person households aged 60 years or more occupy dwellings with three or more bedrooms.

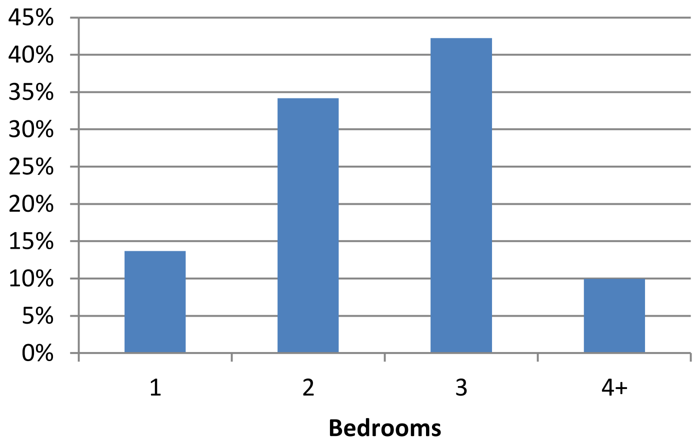
Facilitating downsizing of the family home could not only benefit older Australians by enabling them to supplement their retirement incomes, but would bring wider economic and social benefits by allowing existing housing stock to be used more efficiently. This would not only enable a better match of housing stock with household needs, but could also contribute to housing affordability by adding to the supply of family housing on the market - particularly in inner and middle suburbs where demand is strongest.

Figure 4.3
Size of dwellings occupied by Australians aged 60+



Source: ABS Census 2011

Figure 4.4
Number of bedrooms: lone person households aged 60+



Source: ABS Census 2011

However, there are a number of tax and social security impediments to downsizing, including:

- The exemption of the family home from the assets test governing eligibility for age pensions represents a significant incentive for older people to consolidate their assets in the family home. While the family home does not count towards the assets test, proceeds from the sale of the home do. Thus downsizing the family residence in order to release capital is likely to reduce age pension eligibility. There is some evidence to support the contention that this acts as a disincentive to downsizing for those on age pensions: '*While pensioners have a higher probability of moving than those not on the age pension, they have lower probability of trading down as compared to non-pensioners*' (Sane and Piggott 2011)

- High rates of land transfer (conveyance) duty imposed by states on the transfer of housing assets represent a significant disincentive to residential mobility, including downsizing. In Victoria, for example, the purchase of a replacement house at the median price of $643,000 in December 2013 would attract land transfer duty of the order of $42,000 while a median priced unit of $498,000 would attract a duty of $21,850; and

- Exemption from capital gains tax represents an additional incentive to concentrate household assets in the family home which may represent a further impediment to older people converting equity in the home into income-generating investments.

Given the value of the family home is already excluded from the assets test governing eligibility for the age pension, there should be no net cost to the federal budget if equity released from the exempt asset were invested in eligible retirement income generating products without affecting eligibility for the age pension[7].

Tackling disincentives associated with state land transfer duties could prove more difficult as this represents one of the largest sources of revenue for cash-strapped states. However, a case might be made for a targeted one-off exemption from conveyance duty, provided it was limited to eligible retirees wishing to downsize in order to release equity for investment in an eligible retirement income generating product. Were this to be done in tandem with the federal government offering a matching exemption from the age pension income and assets tests, an argument could be mounted that the additional housing turnover resulting from the removal of these two disincentives could generate sufficient additional state conveyance duty to at least offset the revenue lost from the exemption.

One jurisdiction has already opened the door to such an option, The ACT Pensioner Duty Concession Scheme offers a concessional rate of conveyance duty to eligible pensioners seeking to move to accommodation more suited to their needs but who find the duty involved to be a significant impediment. An evaluation of the effectiveness, costs and benefits of this concession could furnish useful insights as the scheme has been in place since 2008 and in 2012 was extended for a further three years.

[7] The 2013 Budget announced a pilot scheme to protect the proceeds of sale of age pensioner's homes from the assets test provided they place the sale proceeds into a special bank account. However it is not clear that this will now go ahead [http://www.humanservices.gov.au/corporate/publications-and-resources/budget/1314/measures/older-australians/47-10907]. Separately, the Productivity Commission recommended a Government-backed line of credit secured against older people's principal residence to release funds to finance co-contributions to the costs of aged care Productivity Commission (2011). Caring for Older Australians, Final Inquiry Report. Canberra.

***The inquiry should investigate the costs and benefits to the Commonwealth of exempting equity from sale of an age pensioner's family home from the age pension assets test, and the states and territories providing a one-off exemption from land transfer duty the purchase of a cheaper residence using the balance of the sale proceeds, provided the equity thereby released is invested in eligible retirement income producing products*. *This investigation should include an assessment of the effectiveness, costs and benefits of the ACT Pensioner Duty Concession Scheme in place since 2008*.**

The inquiry should also assess the wider economic and social benefits of removing these impediments to downsizing - including better matching of existing housing stock to household needs and improved housing affordability.

4.5 Lifting the quality and independence of financial advice

In its stock-take of the financial system in 1997 the Wallis Inquiry concluded that, while the deregulatory reforms that followed the 1979 Campbell Committee had delivered many of the benefits envisaged, the one exception was: '…*the provision of information and advice which still appears to be in need of further developme*nt' (Commonwealth of Australia 1997) (598).

Sadly, this remains a key area for improvement more than 15 years on. Yet with more and more Australians reliant on superannuation savings that are exposed to market risk, the need for a strong, professional, independent financial advisory sector has never been greater.

Perhaps due to low levels of financial literacy, perhaps to lack of time, many individuals make ill-informed investment decisions that adversely affect their retirement incomes. The consequences of poor financial decisions are particularly serious for older Australians who have limited opportunities to recover. Factors that can contribute to poor investment decisions include:

- low levels of financial literacy, including a poor understanding of the relationship between risk and return,
- optimism bias,
- insufficient time devoted to financial planning,
- increased complexity of financial products and markets,
- the cost of independent financial advice,
- failure to seek or act on professional advice,
- poor quality or conflicted financial advice, and
- cognitive impairment in older age.

4.5.1 Financial literacy

Despite recent efforts to improve financial education, many Australians have a poor grasp of even the basic concepts of financial literacy (Gerrans P and Hershey D A 2012). Less than half of those over 50 surveyed by National Seniors correctly answered simple questions on the relationship between risk and return. Disturbingly, it is those who know least about how their superannuation funds are allocated that are least concerned about outliving their savings. Yet, in an environment of increasingly complex financial products, institutions and services, the level of knowledge and understanding required to exercise choice and make sound investment decisions goes well beyond the basic.

Unsophisticated investors are particularly vulnerable to purveyors of complex financial products that may be totally unsuited to their circumstances. Over the past decade, failed ventures such as Storm

Financial have highlighted how readily unsophisticated investors can be drawn into highly geared investments schemes not subject to prudential regulation, or put their savings into vehicles such as mortgage trusts in the misguided belief they have similar protections to deposit-taking institutions. Many older Australians who suffered substantial losses through superannuation and other investments in these schemes or as a result of the GFC were unaware that their capital was at risk and many lost their retirement savings and even their homes in this way.

While an increased effort to improve financial education is a laudable and desirable goal, it is our contention that the average citizen is never likely to be sufficiently financially literate to navigate the complexities of today's financial system. This underscores the growing importance of access to affordable, high quality and genuinely independent professional advice. It also raises the question of what can be done to improve financial *awareness* (as distinct from financial *literacy*) to help people navigate the system, understand who does what and whom to trust.

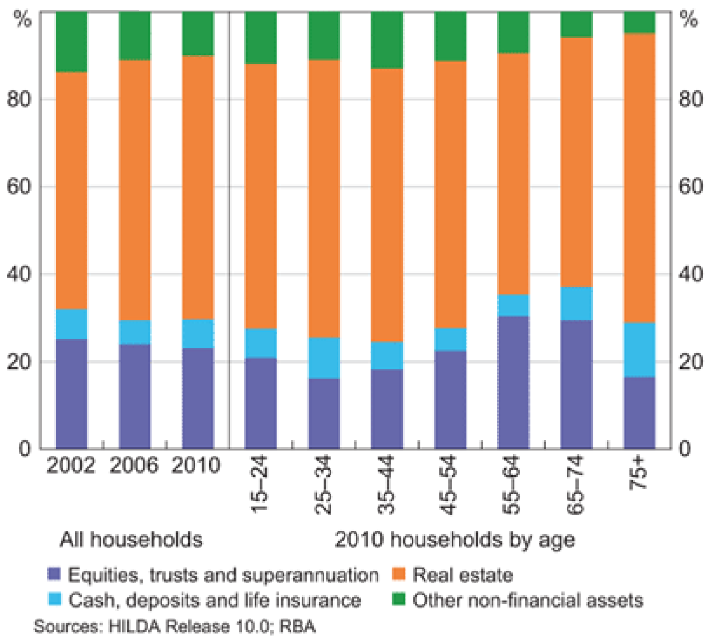
4.5.2 Growing reliance on financial advice

The mounting emphasis of Australia's retirement incomes policy on self-provision through both mandatory superannuation and voluntary savings means that individual Australians now have greater responsibility for managing their finances to see them through retirement. Increased reliance on superannuation and direct equity investments also means that individuals are now more exposed to financial and longevity risks. Such risks could be particularly problematic for those in self-managed funds should they suffer cognitive deterioration as they become older.

These exposures are greatest for Australians in the 55-74 year range. As shown in Figure 4.5, in 2010 this age group held a larger proportion (around 30 per cent) of household assets in equities, trusts and superannuation than any other age group.

Figure 4.5

Composition of Assets (Mean)



Source: Reproduced from (Wilkins R (ed) 2013)

There is compelling evidence that those who access financial advice services generally benefit from doing so (KPMG Econtech 2009). However, less than 40 per cent of the population has ever used a financial planner. Among the reasons for underutilization of financial advice are (Australian Securities and Investment Commission 2010):

- cost (with a significant gap '... *between what consumers are prepared to pay for financial advice and how much it costs industry to provide advice*');
- the scale of advice (with many consumers wanting more piecemeal advice than suppliers wish to offer); and
- consumer mistrust of financial planners.

That said, older Australians do appear more likely to seek financial advice, with National Seniors' research suggesting as many as 85 per cent of retired couples have obtained professional advice and over 70 per cent of those with superannuation have done or intend to do so. However, those who are least financially literate are least likely to seek professional advice (National Seniors Productive Ageing Centre 2012).

On independent financial advice…

When I checked the detail on my annual pension statement I discovered that over $300 per month was being taken out by a Financial Advisor who had taken over [the financial advisory group] with whom I set up the pension. I did not know the man. I met him for one hour. He bullied me - trying to get me to pay him $2000 to switch me to another fund (which I subsequently learned owned his franchise and from whom cash bonuses and holidays were given to advisors to promote extra business) when I had paid $4000 two years earlier, on the advice of his predecessor, to enter the fund I am with.

When I finally woke up to what was happening, I got rid of him. Now I draw extra income, and the capital of my pension fund has increased.

– National Seniors member (2014)

4.5.3 Quality and independence of financial advice

While recent reforms have targeted the integrity of the financial advice sector, problems of quality and conflict of interest persist.

In a shadow shopping survey of retirement financial advice, ASIC found only 3 per cent to be of good quality and while 58 per cent were adequate, almost 40 per cent were judged to be of poor quality (Australian Securities and Investment Commission 2012).

ASIC also found evidence that conflicts of interest had a detrimental effect on the quality of advice being delivered. Disturbingly, in 78 per cent of the advice examples the adviser was remunerated through product commissions or fees that were based on a percentage of the client's assets or investments under advice.

Yet, despite this adverse independent assessment of the quality and objectivity of this advice, over 80 per cent of participants in the ASIC study believed they had received good quality advice and trusted the advice they received.

These findings make a mockery of the notion that the average investor has the capacity to make informed judgments about the quality of financial advice or about whom they can trust to deliver it. They challenge the whole philosophy of disclosure and education as the basis of consumer protection in the non-prudentially regulated sector (FINSIA 2009).

To be beneficial, financial advice must be professional, personalised and genuinely independent. However, with the major banks and insurance companies that are manufacturing financial products now also owning investment advisory services the issue of 'conflicted remuneration' has become increasingly problematic. While the FOFA reforms were designed to address this issue, amendments proposed by the incoming Coalition government would substantially dilute their effectiveness in dealing with conflicted remuneration.

National Seniors submit that any cost savings for consumers resulting from the scaling back of the FOFA legislation will be eroded by the increased risk and loss of certainty, understanding and awareness resulting from the proposed amendments. In particular, National Seniors consider that:

- *The opt-in requirement must be retained.* Removal of this requirement would represent a major consumer detriment by taking the onus away from advisers and putting it on to investors to monitor what ongoing service they receive from their planner for the fees they are charged.
- *The annual fee disclosure statements requirement for all clients must be retained*. Unless this is done, investors will have no way of knowing how much they've paid to product providers and advisers.
- *Advisers must be compelled to take into account their clients' individual circumstances when they deliver scaled advice.* The proposal shifts the responsibility from the adviser back to consumers to assess scaled advice in the light of their individual circumstances. The amendment ignores the fact that consumers will always be the less powerful party when agreement is formed on the scope of any scaled advice; and planners and advisers in the scaled advice situation can simply advance a particular product to a consumer investor without considering the consumer's overall position.
- *Advisers should be free of any real or perceived bias at all times regardless of what type of advice they are providing clients.* National Seniors does not subscribe to the argument that general advice by its nature is less likely to influence a person's financial decision making. Commissions create a conflict of interest by linking advice on specific products to securing personal financial gain from commission payments.
- *The 'Catch All provision' in the best interest duty must be retained.* Removing the 'catch-all' aspect of the duty to put the client's interests first will make it easier for advisers and planners to defend actions by investors claiming for their losses. It will basically reinstate the pre-FOFA position.

4.5.4 Professional qualifications

A further set of concerns relates to whether the professional competencies and educational standards of financial advisers are adequate to ensure quality advice.

While there are some highly qualified professionals in the financial advice sector, and stricter licensing conditions for financial planners, the barriers to entry for providers of general financial advice are low. This puts the onus on consumers to make judgments about whom they can rely on and has led some to question why the educational qualifications that investment advisers should be less, for example, than for accountants. Valentine (Valentine 2013) suggests adviser education should include a solid academic grounding in the theory of investment and asset markets, which would imply the need for tertiary level qualifications.

4.5.5 Professional standards

Effective professional self-regulation could provide a lower cost alternative to additional regulatory controls or mandated minimum standards for financial planners and advisers, but the industry has been slow to develop these.

In 2010 the Accounting Professional & Ethical Standards Board issued an exposure draft standard for financial advice professionals that banned commissions on investments and life insurance, asset fees, soft dollar benefits, volume bonuses and any other sales incentives of whatever kind

(Accounting Professional & Ethical Standards Board 2010). However, the final standard released in 2013 (Accounting Professional & Ethical Standards Board 2013) introduced an optional alternative tier of ethics allowing conflicted remuneration (subject to the provisions of FOFA). Where this option is adopted, the accountant is required to include additional disclosures and must obtain 'written informed consent'.

While it would be in the interests of financial advice professionals to demonstrate their credibility by adopting the higher of the two standards, there is some evidence that advisers are opting for the softer option that allows conflicted remuneration, subject to disclosure. Yet even this softer version of APES230 appears superior to the requirements of the law if the Coalition's proposed amendments are passed.

The Inquiry should consider how best to lift the quality and integrity of the financial advice sector including: whether conflicted remuneration and percentage fees should be allowed; whether minimum educational standards for financial advisers should be lifted; and whether the tougher of the APES 230 financial advice standards should be adopted by ASIC as a licensing requirement for financial advisers.

The inquiry should also consider what can be done to improve financial awareness (as distinct from literacy) to help people navigate the system, understand who does what and whom they can trust.

4.6 Managing impacts of technological change

For older Australians, the rapid pace of technological innovation has been a mixed blessing –beneficial for those who command the necessary skills and resources to utilise new devices and on-line services, but risking exclusion for those without.

National Seniors' research shows older people are particularly concerned about personal safety, privacy and security. As a result, many value the personal face-to face interaction of over-the-counter banking and may consider online banking less 'safe' (National Seniors Productive Ageing Centre 2012).

Some key issues for older Australians in relation to technological innovation include:

- The greater degree of difficulty experienced by older Australians in keeping up with technological changes in order to take advantage of the benefits offered by new products, services and media; and to avoid exclusion;
- Consumer protection issues arising from greater complexity and reduced transparency of financial products; and
- Addressing the greater sensitivity of older Australians to privacy, safety and security issues.

On technological change…

A number of older people in our regional area have never been exposed to computers and the internet as these facilities have not been part of their culture living out of town. Mobile phones don't work in many areas around regional centres and landlines can be intermittent, so internet has simply not been a viable option to them. …This means that, once they move off the family property, they are immediately up to decades behind their counterparts in the town they move into. If it isn't available on the farm, then as people age and move into aged facilities or property in town, the knowledge of how to operate the service is not there, even if the facility is now available to them.

- National Seniors member 2014

4.6.1 Internet use by older Australians

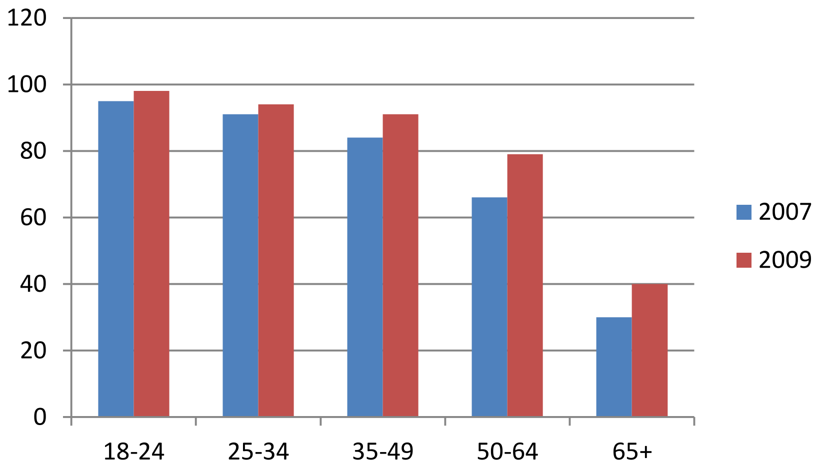
For those older Australians who experience mobility difficulties, the internet offers opportunities to maintain independence, keep in touch with friends and family and manage their banking, shopping and entertainment needs from home.

However, Figure 4.6 shows that Australians in older age cohorts are the least likely to have access to or use the internet. This is particularly so for those residing in rural and regional Australia where internet access is restricted.

Internet usage by older Australians has nevertheless been rising. In 2007, around two thirds of 50-64 year olds and just 30 per cent of those over 65 years were regular internet users; but just two years later these percentages had increased to 79 per cent and 40 per cent respectively (Ewing and Thomas 2010). This trend is certain to continue as younger cohorts more familiar with the internet and mobile communications devices and applications progressively move into older age groups.

National Seniors research suggests the most common uses of the internet by the current generation of older Australians are to check email, search or browse the web, use a bank's online services and check weather forecasts (National Seniors Productive Ageing Centre 2011).

Figure 4.6
Australians' Internet Usage by Age: 2007 and 2009



Source: (Ewing and Thomas 2010)

Other research shows that, in 2009, 63 per cent of Australians aged 50 and over had purchased goods on-line, 52 per cent used on-line banking services and 37 per cent used the internet to pay bills (Ewing and Thomas 2010).

Again, these percentages are bound to rise as younger cohorts age.

Even so there remains an ongoing risk that successive older generations will be excluded from financial services employing the most recent technologies.

Of course it is not only the old who experience problems using internet services, which points to a more general need to make e-services safer and more easily used, including improving user interfaces.

4.6.2 Barriers to internet use

While the National Broadband Network promises to improve access to the internet for those who are homebound, improving access alone will not address some of the current barriers to greater use of the internet by senior Australians.

National Seniors Survey data (National Seniors Productive Ageing Centre 2011) show the main barriers to internet use among older Australians to be:

- 'Don't know how to use internet/lack of skills',
- 'Confused by the technology',
- 'Cost', and
- 'Concerns over security and viruses

In considering the impacts of technological innovation, the Inquiry should examine how best to ensure the safety and security of on-line financial services. While this is critical for all age groups, older Australians are more highly attuned to risks associated with on-line services and may therefore be less likely to benefit from internet based technological advances.

The inquiry should also consider how to improve access for older Australians to the internet and to mobile devices so that they might share in the benefits offered by these technologies.

The inquiry should consider whether additional protections should be included - possibly in an industry code of conduct - to ensure that when financial institutions and providers plan to 'shut down' services that do not rely on the internet or contemporary ICT technologies, due care is taken to avoid excluding, marginalising or disempowering those who with limited access to or ability to utilise these technologies.

Going online to find lost money…

My friend has just had $3,000 confiscated by his bank (without any prior notification) because of the Government's no activity for three years on the bank account rule…. There is real fear in the community at present, because of this Government action, and the process of getting the funds back is not simple. You need to get statutory declarations and many people don't even know what that is. For the elderly it is a nightmare situation.

- National Seniors member (June 2013)

Email National Seniors to ASIC May 2013

We'd like to put something in our June magazine for our 200,000 members about money from unused bank accounts being transferred to ASIC. We've had lots of media interest today plus concerns coming up from the grassroots. People want to know how they can get it back if they need it quickly.

Email ASIC to National Seniors May 2013

How people can get it back:

Log onto ASIC's free online database at www.moneysmart.gov.au, follow the link to unclaimed money, and type in your name. If you find some money that you think might be yours, you will need to prove the money belongs to you or that you are the beneficiary.

Information on how to make a claim is also available on the MoneySmart website. https://www.moneysmart.gov.au/tools-and-resources/find-unclaimed-money#claim

Email National Seniors to ASIC, May 2013

And, if they're not online…is there a MoneySmart number to ring?

Email ASIC to National Seniors, May 2013

Unfortunately, no we don't have a number for people to call. However, people can call their bank to see if their account has been transferred to ASIC.

Email National Seniors to ASIC, May 2013

That's a shame. It's the elderly people who don't have internet access who will be lost and confused, and probably suddenly really needing the money that they thought they'd tucked away for a rainy day.

5 Conclusion

While the financial system reforms of the 1980s and 1990s have served Australia well, the effects of ongoing globalisation, technological innovation, increased complexity and a series of financial failures – most particularly the Global Financial Crisis - all point to the need for a rebalancing of the regulatory framework in favour of greater stability and greater safety for consumers.

When even relatively financially aware consumers find it difficult to navigate the system safely without expert assistance, a ‘buyer beware’ regulatory regime that relies on disclosure as its chief means of consumer protection is clearly no longer adequate, especially for those with poor levels of financial literacy.

One of the most significant developments of the past two decades has been the growing systemic importance of superannuation - both as a source of retirement income for older Australians, and as a source of capital to fund future economic growth. This has significant implications for the allocation of financial risk within the Australian economy – both between traditional deposit taking institutions and superannuation funds, and between government, financial institutions and households.

Of particular concern is the growing household exposure to market and longevity risk as retirement incomes policies push more and more retirees towards greater reliance on superannuation savings. Addressing the implications of this transfer of risk from institutions to households – and particularly to older Australians - should be a major focus of the current inquiry.

Finally, while ongoing technological innovation will continue to create new value for consumers of financial services and products, as the population ages and reliance by older Australians on financial products and services continues to grow, it will become increasingly important to ensure that older generations are not excluded from financial services employing the latest technologies.

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