Australia's productivity performance

FSC Submission to Productivity Commission

March 2022

FSC FINANCIAL SERVICES COUNCIL

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FSC FINANCIAL SERVICES COUNCIL

1 About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advice licensees. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

The FSC's mission is to assist our members achieve the following outcomes for Australians:

- to increase their financial security and wellbeing;
- to protect their livelihoods;
- to provide them with a comfortable retirement;
- to champion integrity, ethics and social responsibility in financial services; and
- to advocate for financial literacy and inclusion.

2 FSC Recommendations

The FSC recommends:

- the Commission examine the importance of individual Australian industry sectors to productivity and performance of the whole Australian economy, and target its reform recommendations at the sectors that are the most interconnected and have the greatest potential to drive productivity and growth in the rest of the economy.
- the Commission publish updated international comparisons of industry productivity.
- an independent review of the rules for regulatory analysis, compliance with the rules, and their implementation by the Office of Best Practice Regulation (OBPR).
- an ongoing program to review financial services regulations, presuming the removal or reform of regulations that are not fit for purpose, adversely affect competition, or where consumer protections can be delivered at lower cost.
- the prioritisation of tax reform, focussing on reducing or removing the most inefficient taxes – eliminating specific taxes on insurance, and reducing the company tax rate.
- the preferred approach to implement policy change is through the use of industry codes and standards in preference to regulation or legislation.
- a change to the Managed Investment Trust (MIT) start-up concession from two to five years, with the extended period available to managed funds that are being actively marketed with the intention that the MIT requirements will be satisfied.

In addition, there are a number of specific recommendations in Sections 5.1, 6 and 6.1.2 of this submission.

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3 Introduction

The FSC welcomes the opportunity to provide a submission to the Productivity Commission (**the Commission**) in relation to Australia's productivity performance.

As the Commission highlights, Australia's productivity performance has slowed in recent years,[1] and a boost to productivity is needed to ensure Australian living standards grow. As the Commission states:

> *Australia's improvement in living standards since federation is largely explained by productivity growth.*[2]

Given this, the FSC strongly supports a review to identify reforms to return Australia to a higher rate of productivity growth. This will clearly benefit the Australian people by boosting wages growth, retirement savings, and overall wellbeing.

The FSC submits that a critical part of this will be reforms to boost productivity growth in financial services.

3.1 Importance of financial services to rest of economy

Financial services is one of the largest industry sectors in the economy – since 2003, this sector has been the second or third largest sector in the economy.[3] As a result, the impact of productivity growth in financial services on the rest of the economy is substantial. Financial services represents just under 10 per cent of total industry value added,[4] and is 11 per cent of the industry sectors where productivity is regularly measured.[5]

The FSC notes that capital markets, fund managers, superannuation funds, and wealth managers more generally help allocate capital efficiently across the economy, reallocating capital away from less productive and towards more productive/efficient sectors. As a result, financial services helps drive productivity growth in the rest of the economy.

The FSC also represents Australia's life insurers that not only act as wealth managers, but also help individuals manage significant personal risks to life and income, reducing the need for Government support. Insurance helps individuals and households in their time of greatest need, improving peace of mind, and permitting the call on taxpayers to be reduced.

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[1] Figure 1 of Productivity Commission (2022) Australia's productivity performance – call for submissions.
[2] Page 1 of op cit.
[3] Source: ABS Australian National Accounts, Table 6.
[4] Source: ABS Australian National Accounts, Table 6.
[5] ABS Estimates of Industry Multifactor Productivity, Australia, Table 6.

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International evidence indicates:

- financial services is highly interconnected with the rest of the economy, and could be the industry that is the most 'interconnected' with other industries.[6]
- "the preponderance of evidence suggests that both financial intermediaries and markets matter for growth"[7]
- financial frictions (which would include poor financial services productivity) are a significant cause of cross-country differences in productivity.[8]

This evidence points towards a well-developed financial services sector as being essential to development. The international evidence above could be usefully supplemented by Australian evidence, and should be used by the Commission to focus its review process.

The FSC **recommends** the Commission examine the importance of individual Australian industry sectors to productivity and performance of the whole Australian economy, and target its reform recommendations at the sectors that are the most interconnected and have the greatest potential to drive productivity and growth in the rest of the economy.

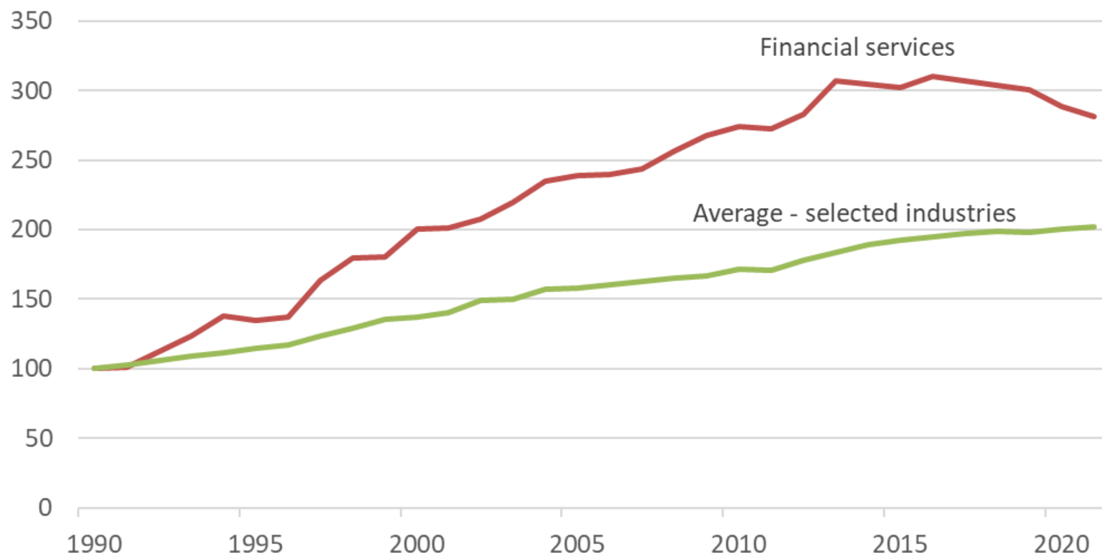
3.2 Productivity performance in financial services

In Australia, financial services until recently was a strong standout performer in productivity growth, with the highest cumulative (labour) productivity growth of all measured industries in the period 1989–90 to 2013–14, and the second fastest to 2019–20.

However, productivity growth in the industry has been negative for the period 2015–16 to 2020–21, as shown in the graph below.

[6] Page 8 of Financial Services Council (NZ) (2017) Towards Prosperity an insight into New Zealand's financial services industry.
[7] Levine (2005) "Finance and Growth: Theory and Evidence", Chapter 12 of Handbook of Economic Growth, Volume 1, Part A, pp865-934
[8] Buera, Kaboski & Shin (2011) "Finance and Development: A tale of two sectors", *American Economic Review,* 101 (5).

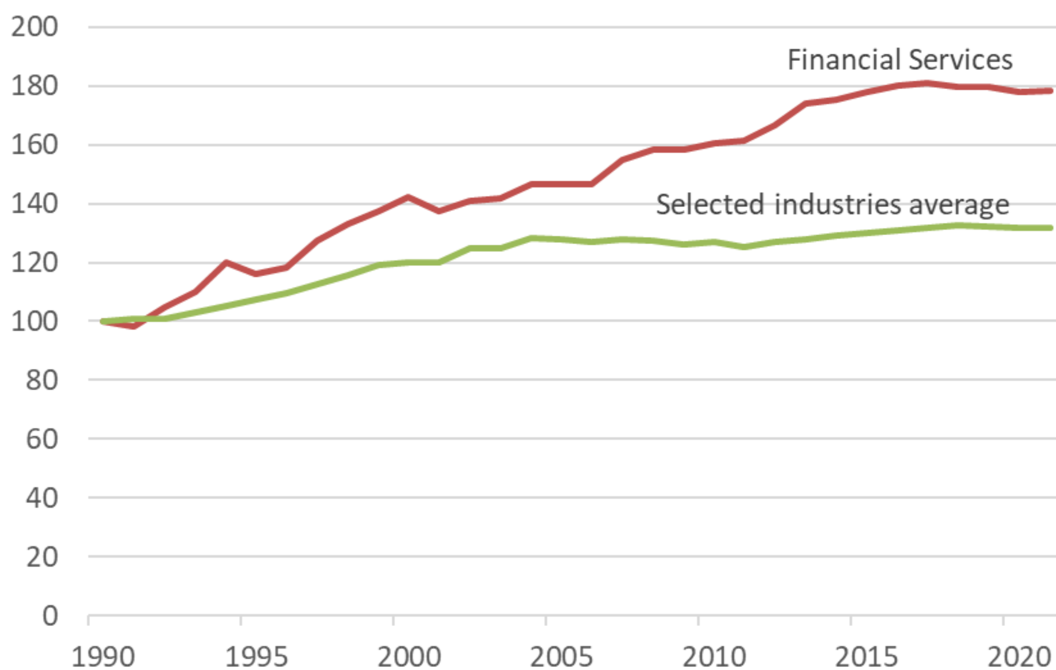
Figure 1 – Labour productivity growth 1990 to 2021 (cumulative)



Source: ABS Estimates of Industry Multifactor Productivity, Australia, Table 6

Similar results occur for multifactor productivity, shown in the graph below – strong growth until around 2015, and then flatlining or decline since then. Despite the recent decline, the cumulative productivity growth of financial services is still the second highest (after agriculture) over the period since 1990.

Figure 2 – Multifactor productivity growth 1990 to 2021 (cumulative)



Source: ABS Estimates of Industry Multifactor Productivity, Australia, Table 1.

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The data above shows the potential for financial services to boost economy-wide productivity growth, but also the need for reform in the sector to ensure the historical strong productivity growth performance is restored.

There is also some evidence that Australia's financial services industry has had high productivity compared with other relevant countries. A Productivity Commission research paper cited data showing that in 2005, financial services in Australia was at the 'productivity frontier'.[9]

The FSC considers it would be beneficial for the Commission to update this international comparison of productivity levels. It may be the case that Australia's world-beating performance for financial services has not been maintained, given the Australian data above showing a slowdown or decline in financial services productivity. However, this will be clarified by updated international data. In addition, updated international comparisons will assist policy makers with determining the priority sectors for reform, and which sectors overseas have policy settings worth emulating.

The FSC **recommends** that the Commission publish updated international comparisons of industry productivity.

3.3 Competition in financial services

An important way to encourage productivity growth is through competition.[10]

A recent study on competition in funds management released by ASIC[11] found the managed funds industry is competitive, as evidenced by new market entrants, innovation and low fees by global standards; and retail and wholesale investors are sensitive to the performance of funds. This study also found management fees in Australia are some of the lowest in the world – a finding that is consistent with Morningstar's 2019 Global Investor Experience Study which found that Australia's managed funds are global leaders in low levels of fees.

This is a pleasing finding. However, there is always more that can be done to promote competition in financial services, including funds management. As noted later in this submission, the FSC supports reforms to regulatory settings that will encourage competition in financial services. This should help encourage productivity growth in financial services.

4 Regulatory issues

This section of the FSC submission provides background on regulatory issues that are facing Australian financial services businesses, particularly the businesses represented by

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[9] Figure 10 of *Productivity Commission (2017) Productivity and Income — The Australian Story, Shifting the Dial: 5 year Productivity Review, Supporting Paper No. 1*.
[10] See for example Andrews, Hambur, Hansell and Wheeler (2022) Reaching for the stars - Australian firms and the global productivity frontier – Treasury Working Paper 2022-01.
[11] ASIC Report 702 – Competition in Funds Management Report.

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the FSC in the sectors of superannuation, funds management, financial advice, and life insurance.

4.1 Implementation issues with reforms

There has been a substantial increase in the regulation of financial services over the past decade. While much of this regulation has been ostensibly to protect consumers, in some cases the regulations have been implemented poorly.

4.1.1 Case study – 'nil complaints' reporting requirement for DDO

A case study of poorly designed regulations, having high costs on business but negligible consumer benefits, comes from a component of the Design and Distribution Obligations (**DDO**) which commenced operation on 5 October 2021.

Initially, the DDO included a requirement for all product distributors (such as financial advisers) to make a regular complaint report to product issuers (such as banks and fund managers) – and the complaint report was required to be provided whether or not the distributor had received a complaint. This so-called 'nil complaint' reporting requirement would have meant several million 'nil complaint' reports would need to be sent every year, based on FSC estimates.

This would have been an onerous red tape burden for many in the industry, and would have particularly hit small financial advice businesses hard. The FSC commissioned an estimate that this burden would have conservatively cost the industry $41 million per year, all for negligible (if not zero) consumer benefit.[12]

Fortunately, the Government announced the nil complaint requirement would be removed, but only on 14 September 2021, merely weeks before the DDO regime was due to start, and after numerous businesses would have built systems to implement the 'nil complaint' reporting requirement.

This is a classic example of purposeless red tape imposed on the financial services industry.

4.1.2 General financial services law

The Australian Law Reform Commission (**ALRC**) is currently conducting a review of the financial services section of the Corporations Act, and made comments including that notional amendments to the Corporations Act through Class Orders being "deeply inaccessible"[13].

The FSC made a submission[14] to the ALRC's Interim Report A that discusses the high level of complexity of the current regulations and law applying to financial services – the

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[12] Note the Regulation Impact Statement on the DDO legislation argued the compliance costs of the new regime *in its entirety*, including the nil complaint requirement, would be $94m per year, which seems a significant underestimate. See Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019 Revised Explanatory Memorandum at paragraph 3.25.
[13] Paragraph 17 of the Report.
[14] See: https://fsc.org.au/resources/2436-fsc-submission-alrc-interim-report-a/file

implementation of reforms from that process should help address the complexity and cost of regulation in this industry.

Some recommendations from the FSC's submission are highlighted in Section 6.1.2 below.

4.2 Additional regulatory burden and slowdown in beneficial reforms

The financial services industry has implemented numerous changes over the past decade, particularly as a result of the Financial Services Royal Commission. A high-level list of the changes implemented by the industry over the past few years is in the figure below.

Figure 3 – recent regulatory changes impacting FSC members

Regulatory changes by regulator

Treasury
- Design and Distribution Obligations (DDO)
- Large increases in financial system supervisory levies
- Your Future, Your Super
- TPB Review
- Extension of Consumer Data Right (CDR) to superannuation and financial advice
- Modernising business communications
- Quality of Financial Advice review
- Portfolio Holdings Disclosure
- Protecting Your Super (PYS)
- Putting Members' Interests First (PMIF)
- Reuniting More Super (ERF closures)
- COVID Early Release of Super
- Work test changes
- Retirement minimum drawdown changes

Tax – FS general
- Filing of financial statements with ATO
- Country by country reporting
- Anti-hybrid rules
- GST on cross-border transactions
- Large increases in penalties for global businesses
- Tightening of R&D tax incentive
- Disclosure of reportable tax positions
- Thin capitalisation changes, including tightening of safe harbour
- Multinational anti-avoidance law (MAAL) and Diverted Profits Tax (DPT)

APRA
- Individual Disability Income Insurance sustainability measures
- AASB 17 insurance contracts and Life and General Insurance Capital (LAGIC) updates
- Superannuation Data Transformation

Royal Commission
- Ending grandfathered commissions
- Compensation Scheme of Last Resort
- Breach Reporting extensions
- Advice fee disclosure statement
- Advice fee opt in
- Limiting advice fees for super
- Disclosure of lack of independence
- Reference checking
- Financial adviser misconduct
- Single disciplinary body
- Financial Accountability Regime
- Remuneration
- Enforceable code provisions
- Financial Regulator Assessment Authority
- Strengthening of anti-hawking regime
- Deferred sales model for add-on insurance
- Avoidance of life insurance contracts
- Duty to take reasonable care not to make a misrepresentation
- Insurance claims handling as a financial service
- Extension of unfair contract terms regime to insurance contracts
- Trustees of Registrable Superannuation Entities (RSEs) to have no other duty

Tax – funds management
- Stapled structures
- Removal of Offshore Banking Unit (OBU) regime
- Frequent changes to Annual Investment Income Report
- Tighter attribution penalties
- Increase in CGT for managed investments
- Increase in withholding tax on agricultural and residential property, reduction for affordable housing

ASIC
- Supervision of remediation
- RG 271: IDR, including reporting requirements in CP 311
- RG 256: consumer remediation, including update CPS 355
- Value of insurance in super (REP 633, REP 675)
- RG 97: Disclosing Fees and Costs in PDS's & Periodic Statements
- Foreign Financial Services Provider regime

Other
- Australian Financial Complaints Authority review
- Australian Law Reform Commission : Review of Legislative framework for Financial Services Regulation
- Department of Social Services: Financial Counsellor funding model
- Foreign Investment Review Board: Changes to foreign investment rules and increases in fees
- Department of Homeland Security: Protecting Critical Infrastructure and Systems of National Significance

ATO
- Top 1000/Top 100 Assurance Reviews
- Remediation tax issues (including impact on superannuation)
- Non-arms length expenditure
- Tax treatment of foreign capital gains (after Burton case)
- Investment Manager Regime auditing

Many of the changes in the diagram above were implemented at substantial costs to the industry, and in many cases these were changes that the industry was not requesting; in some cases the changes were actively opposed by the industry.[15]

The industry has a number of competing reforms which are equally important for consumers, but would also remove red tape and improve productivity.

These reforms include:

- A product modernisation scheme for financial services, as recommended by the Superannuation System Review (the Cooper Review) in 2010,[16] the Productivity

[15] For example, the removal of the Offshore Banking Unit (OBU) regime, the increases in withholding tax on agricultural and residential property, and the increase in CGT on managed funds.
[16] https://treasury.gov.au/review/super-system-review

Commission inquiry into superannuation in 2018,[17] and in submissions by both ASIC and APRA.[18]

  - A product modernisation regime will improve customer outcomes, reduce costs, improve productivity, and increase competition in financial services (along with many other benefits)[19]
  - The Government has announced its support for such a scheme,[20] but it is not yet implemented.

- Several important and already announced tax reforms for financial services, particularly:
  - reforms to the tax treatment of foreign exchange hedging[21]
  - addressing issues with the Investment Manager Regime (**IMR**)[22]
  - extending the attribution regime to a wider range of products[23]
  - widen eligibility for functional currency election[24]

These reforms have already been agreed – but implementation continues to be postponed, which also means the productivity benefits of the reforms are also being postponed.

5 General regulatory proposals

5.1 Addressing issues with regulators

The FSC submits the industry faces a number of challenges in dealings with financial regulators, including the Australian Securities and Investments Commission (**ASIC**), the Australian Prudential Regulation Authority (**APRA**), the Australian Financial Complaints Authority (**AFCA**) and the Australian Taxation Office (**ATO**).

As a result, the FSC considers regulators should:

- Adopt a more consistent, objective and effective in the administration and interpretation of the laws that confer functions and powers.
- Adopt a more personalised relationship model to enable more prompt responses to enquiries, better communication and transparent escalation processes to address both day to day and difficult matters
- Improve coordination between ASIC, APRA and other regulators should be improved. The FSC believes inefficiencies and additional costs arise because of a

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[17] Recommendation 23.
[18] ASIC report 466 *ASIC's work to reduce red tape* in January 2016, see: https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-466-asic-s-work-to-reduce-red-tape/ and APRA submission to Inquiry by the Senate Economics Committee into the *Scrutiny of Financial Advice – Life Insurance* of April 2016.
[19] For more details of the need for product modernisation scheme, and the numerous benefits of a scheme, see the FSC submission to the 2020–21 Budget: https://fsc.org.au/resources/2135-fsc-submission-federal-budget-2021-22/file
[20] See 2020–21 Budget Paper 2.
[21] Announced in the 2016–17 Budget and recommitted in the 2021–22 Budget.
[22] Announced in July 2017: http://kmo.ministers.treasury.gov.au/media-release/064-2017/
[23] Announced in July 2017: http://kmo.ministers.treasury.gov.au/media-release/064-2017/
[24] Announced in the 2011–12 Budget and recommitted in the 2016–17 Budget.

lack of coordination, not only in respect of routine matters but also when it comes to industry-wide issues and long-term processes (see section 5);

- Improve functionality of the ASIC portal for greater ease of operation, particularly in the context of breach reporting and updating of licensee information
- Embrace more digital and technology focussed forms of operating and communicating
- Provide industry with more accommodating timeframes when it comes to responding to notices, information requests, changed deadlines and consultation requests, particularly in relation to draft and final regulatory guidance.
- Provide responses to industry-wide concerns in a timely fashion. As a specific example, the FSC (on behalf of fund managers) requested the ATO provide guidance on the application of a court case (*Burton v Commissioner*) to fund managers on 8 January 2020 and members are still awaiting this guidance. Regulators would never accept this length of delay in response from industry.
- Take a risk-management approach to compliance with compliance targeted areas of higher risk, and minimising or eliminating onerous compliance approaches on low risk entities.
- For regulators that are industry funded, ensure there is substantial oversight over the regulators to ensure they appropriately manage funds that are effectively from the industry they regulate, and are prevented from inappropriate expansions in scope.

5.2 Review of regulatory processes

There have been extensive additional regulations imposed on the financial services sector with limited if any regulatory impact analysis (or comprehensive Regulatory Impact Statements or **RIS**). A diagram of the recent regulations imposed on the sector is in Figure 3 on page 9.

Some of these regulations did not have a RIS as they were able to make use of the "independent review" exemption, but this exemption is only available where the independent review has undertaken a "process or analysis equivalent to an RIS".[25] However, it is unclear whether this exemption should actually apply in many cases – in particular it is debatable whether the recommendations of the Royal Commission into Financial Services were subject to a process equivalent to a RIS. There are also specific exemptions from the RIS process for revenue raising measures, and election commitments.[26]

These exemptions can mean poorly designed regulations can be implemented with inadequate independent scrutiny.

The FSC is also concerned about approaches by regulators (see Section 5 and Figure 3 on page 9) that impose substantial regulatory costs and do not appear to have involved any regulatory impact analysis.

[25] See Office of Best Practice Regulation (2021) Guidance note – Special Cases.
[26] See Office of Best Practice Regulation (2021) Guidance note – Special Cases.

The FSC therefore considers there is a need for regulatory analysis (including RISs) to be applied more broadly, and the scope of exemptions curtailed. There is also a need for a review of compliance with the rules to ensure that major and unnecessary regulatory burdens are avoided.

Also given the implementation of many regulations without adequate RISs, the FSC submits there should be an ongoing program reviewing financial services regulations, with the presumption for the removal or reform of regulations that are not fit for purpose or adversely affect competition. For consumer protection regulations, the review should focus on whether the same protections can be achieved at lower cost.

The FSC **recommends**:

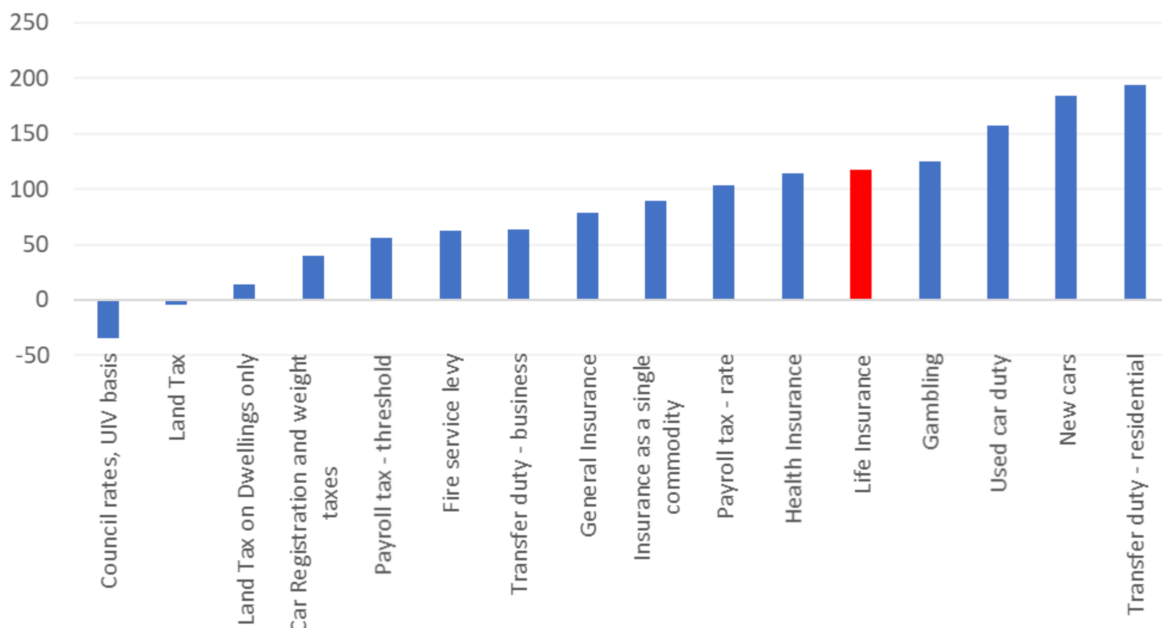
- an independent review of the rules for regulatory analysis, compliance with the rules, and their implementation by the Office of Best Practice Regulation (**OBPR**).
- an ongoing program to review financial services regulations, presuming the removal or reform of regulations that are not fit for purpose, adversely affect competition, or where consumer protections can be delivered at lower cost.

5.3 Tax reform

The FSC submits there will be clear productivity benefits from reducing or removing the most inefficient taxes in the economy. Tax is often one of the most largest costs for businesses and individuals, and the measured inefficiency of some Australian taxes is particularly high.

The priorities for reform should be company tax and stamp duty which are the most inefficient taxes in Australia. Stamp duty on life insurance is one of the most inefficient state taxes, as shown in the figure below.

Figure 4 – Relative inefficiency of state taxes



Source: Table 2-1 of CoPS study for NSW Review of Federal Financial Relations.[27]

The FSC's submission to the NSW Review of Federal Financial Relations[28] highlights the following research:

- Research from the Centre for International Economics found replacing State insurance duties and conveyancing duties with Federal taxation would increase GDP by 0.6 per cent in the long term.[29]
- Deloitte Access Economics found that taxes on insurance had the second highest efficiency cost of all State taxes.[30]
- KPMG Econtech analysis for Henry Tax Review found insurance taxes were less efficient than any federal tax, and the third most inefficient tax overall.[31]
- An ANU working paper by Chris Murphy found insurance taxes are less efficient than personal tax, GST, municipal rates and land taxes.[32]

More details are in the FSC's submission to the NSW Review of Federal Financial Relations.[33]

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[27] Nassios, J., J. R. Madden, J. A. Giesecke, J. M. Dixon, N. H. Tran, P. B. Dixon, M. T. Rimmer, P. D. Adams and J. W. Freebairn (2019). *The economic impact and efficiency of state and federal taxes in Australia*. CoPS/IMPACT Working Paper G-289.
[28] See: https://fsc.org.au/resources/1897-fsc-submission-nsw-review-of-federal-financial-relations/file
[29] Centre for International Economics (2009) State Business Tax Reform – Seeding the tax reform debate – report for Business Coalition for Tax Reform
[30] Deloitte Access Economics (2011) Analysis of State Tax Report 2011 – Report for Finance Industry Council of Australia
[31] KPMG Econtech (2010) CGE Analysis of the Current Australian Tax System
[32] Chris Murphy (2016b), "Efficiency of the tax system: a marginal excess burden analysis", *ANU Tax and Transfer Policy Institute Working Paper*, 4/2016
[33] See: https://fsc.org.au/resources/1897-fsc-submission-nsw-review-of-federal-financial-relations/file

Similarly, much of the research emphasises the large economic costs of company tax, with:

- The KPMG Econtech analysis for Henry Tax Review finding this was the most inefficient federal tax.
- The ANU working paper by Chris Murphy finding this is the second most inefficient tax in Australia after stamp duty on commercial conveyancing.

The prioritisation of reform of company tax is consistent with the recommendations of the IMF and OECD that company tax reductions are a priority for Australia.[34] More details on the uncompetitiveness of Australia's company tax system, and citations of significant research showing the harmful impact of this tax, is contained in the FSC's submission to a Parliamentary Inquiry into Diversifying Australia's Trade and Investment Profile.[35]

The FSC **recommends** the prioritisation of tax reform, focussing on reducing or removing the most inefficient taxes – eliminating specific taxes on insurance, and reducing the company tax rate.

5.4 Industry codes and standards

The FSC submits that industry-led solutions to issues provide substantial benefits and can often provide better solutions than legislation or regulation.

Several examples of codes and standards being developed by FSC members are outlined in the FSC's Attached Pre-Election Policy Priorities. In summary:

- The FSC has worked with members to develop an enforceable standard that will remove occupational exclusions and occupation based restrictive disability definitions in default life insurance cover in superannuation. This should make superannuation members more confident that they will be able to claim on any default insurance they hold inside superannuation.
- The FSC's Life Insurance Code of Practice started on 30 June 2017, and sets out minimum standards of practice, conduct and disclosure for insurers when dealing with customers, including vulnerable customers, in every aspect of a customer's journey from taking out a policy to making a claim. The next iteration of the code, currently in development, will introduce many new consumer protections in product design, sales practices, claims and providing greater support to people with a mental health condition.
- The FSC is currently developing a Climate Risk Disclosure Guidance Note to enable fund managers and investment managers to have consistent methods of assessing and reporting climate risk to their portfolios and operations, and reliable labelling of features in their investment products that claim to address climate risk.

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[34] IMF Australia Article IV Consultation, 2015, 2017, 2018, 2019 and 2020 and OECD Economic Surveys for Australia for 2012, 2013, 2015, 2017 and 2019.

[35] See pages 15–17 of FSC (2020) Submission to Parliamentary Inquiry into Diversifying Australia's Trade and Investment Profile: https://fsc.org.au/resources/2057-fsc-submission-parliamentary-inquiry-into-diversifying-australia-s-trade-and-investment-profile/file

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The FSC **recommends** the preferred approach to implement policy change is through the use of industry codes and standards in preference to regulation or legislation.

6 Specific regulatory proposals

It is also important for there to be an ongoing program of regulatory reform to address the main regulatory issues in financial services. The priority reforms of industry are outlined in the FSC's Pre-Election Priorities document, attached to this submission.

In summary the key recommendations are:

- Providing stability and certainty in the tax and contribution rules for superannuation to build public confidence in the system.
- Introduce a new investment vehicle that will make it significantly easier for superannuation funds to invest in infrastructure, unlocking potential investment of just under $2 trillion dollars. The proposal will allow better matching of existing patient capital with Australia's well known infrastructure needs, and does not require any additional Government infrastructure spending.
- Review the Your Future, Your Super benchmarks assessment to facilitate accurate measurement of funds, ensure that the reforms are working as intended and to assess whether there have been any unintended consequences.
- Remove unnecessary product disclosure requirement for superannuation, given the extensive other requirements (particularly Your Future, Your Super and the Design and Distribution Obligations) In particular, remove the MySuper product dashboard and cease plans to extend the dashboard further, cease the APRA heatmaps, and remove the member outcomes assessment.
- Review the regulations that prevent private health insurers from funding community-based mental healthcare activities, and permit life insurers to fund mental health treatments for their insurance clients on a discretionary basis (in line with previous Productivity Commission recommendations).
- Reduce the cost of financial advice by almost $2000 or by 35-37 percent by implementing FSC's recommended reforms particularly:
    - Remove the financial advice 'safe harbour' steps, which FSC research has found is a key driver of cost and a key reason why affordable advice is unavailable.
    - The Statement of Advice should be abolished and replaced with a Letter of Advice with scalable obligations.
- Implement already agreed tax reforms for financial services, particularly:
    - Reform the tax treatment of foreign exchange hedging[36]
    - address issues with the Investment Manager Regime (**IMR**)[37]
    - extend the attribution regime to a wider range of products[38]
    - widen eligibility for functional currency election[39]

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[36] Announced in the 2016–17 Budget and recommitted in the 2021–22 Budget.
[37] Announced in July 2017: http://kmo.ministers.treasury.gov.au/media-release/064-2017/
[38] Announced in July 2017: http://kmo.ministers.treasury.gov.au/media-release/064-2017/
[39] Announced in the 2011–12 Budget and recommitted in the 2016–17 Budget.

- Implement a regime to facilitate the transition of existing managed funds into the Corporate Collective Investment Vehicle (CCIV), and fix the complex tax rules that apply to CCIV sub-funds that fail the 'widely held' test.
- Implement other important tax reforms, including simplifying the complex system of withholding taxes, reform existing tax treaties, and ensure the correct Australian taxation of foreign capital gains.
- Expand the current start-up concession for the Managed Investment Trust (**MIT**) regime – see more details in Section 6.1.1 below.
- Minimise unnecessary barriers to foreign investment, with the fees for foreign investment assessment set no higher than cost.
    - A recent review by the Productivity Commission[40] showed that current fees are *much* higher than costs, which will clearly have detrimental impact on foreign investment and just acts as an additional (and unwarranted) tax on investors and investment managers.
- Ensure the financial services Compensation Scheme of Last Resort (**CSLR**) is truly 'last resort' by ensuring licensees covered by the CSLR are adequately capitalised and have adequate indemnity insurance.
- Ensure that legislation and regulations are genuinely technologically neutral, facilitate electronic execution of documents, allow legal notices to be published online, and broaden the cases where electronic payments are permitted.
- Implement various reforms to the Design and Distribution Obligations (DDO), particularly the following reforms that should improve customer outcomes while reducing red tape:
    - Allow retail distribution to occur during Target Market Determination (**TMD**) reviews unless there is significant risk of consumer harm;
    - Ensure distributors can tailor product offerings to customer needs under DDO without this being classified as personal advice. For example, allow a fund manager to ask a customer if they are after a high or low risk product, and filter the product list to meet this need. Currently, it is unclear if this is permitted under law.
    - Remove all DDO obligations from the provision of disclosure documents (including PDSs), as this is an unnecessary compliance burden that could prevent consumers from receiving disclosure documents; and
    - Ensure that TMDs cannot restrict the provision of general advice or personal advice on a product, as these restrictions could significantly hamper disclosure and competition.
    - Remove any regulations restricting the ability for businesses to comply voluntarily with DDO, as this will enable the customer protections in the DDO to apply to more transactions and customers.
- Introduce a product modernisation (or product rationalisation) scheme in financial services covering funds management, life insurance and superannuation.[41] This

[40] Productivity Commission (2020) *Foreign Investment in Australia*, Commission Research Paper.
[41] The announced schemes to date do not extend a product modernisation scheme to superannuation, but the FSC argues there is a clear case for this extension, as detailed in the FSC's submission to the 2020–21 Budget – See: https://fsc.org.au/resources/2135-fsc-submission-federal-budget-2021-22/file

reform will boost productivity in the industry and enhance competition. For more details see section 4.2 above, and previous FSC Budget submissions.[42]

The FSC also supports standardisation of the format of health reports generated by GPs for life insurers, and make these reports available to insurers through Digital Health records. This would reduce a major friction point between GPs and the insurance sector, save GPs time, and allow customers to 'shop around' their reports to get the best price.

6.1.1 Managed Investment Trust (MIT) start-up concession

There is an important tax-related barrier that is currently acting as a major barrier discouraging fund managers from establishing new managed funds. This is the Managed Investment Trust (**MIT**) start-up concession. There are important tax advantages for retail customers when a managed fund has MIT (or Attribution MIT) status – and conversely tax penalties if a managed fund loses MIT status (including higher capital gains tax and higher withholding taxes imposed on end investors).[43]

Under current rules, a managed fund has leeway of two years to try to meet the entry requirements for MIT status – and if the fund is unable to meet the entry requirements within two years, it will lose MIT status and can be subject to substantial tax penalties.

In practice, this two year timeframe is inadequate for many funds. In practice, funds generally need a 2 to 3-year track record before starting to gain any sales traction and up to 6 years to become properly established.

Most investment platforms require sufficient ratings on a fund before it would consider placing the fund on its platform. However, in order for a fund to get a rating, the fund first needs to be established before it can be presented to a ratings agency. Most ratings agencies operate on a 12 month cycle in reviewing different products (rotating between different product types). Therefore, it may sometimes take up to 12 months for a particular fund to get a rating. The starting rating would generally be a 'neutral' rating. There is then an additional period of 12 to 24 months before a fund may achieve a 'favourable' rating. Many platforms would only consider products which have a favourable rating. Given the competitive landscape, there is no guarantee that a platform would take the fund onto its platform even with a favourable rating. Platforms would typically undertake its own research, having regard to the ratings, and most would expect to see a proven demand for a product before they will consider offering it on their platform. Based on FSC member experience, most funds have a 3-5 year window to get any traction.

In addition, this can become a self-fulfilling problem. Investors and advisers will avoid a new fund if there is a risk of a tax increase, thus making it hard for the fund to meet the test for MIT status, thus increasing the likelihood of a tax increase.

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[42] See FSC submission to 2020–21 Budget: https://fsc.org.au/resources/2135-fsc-submission-federal-budget-2021-22/file

[43] Other potential tax increases include increased loss of deemed fixed trust status, difficulty in using prior year tax losses, difficulty in using franking credits, and loss of ability to use attribution 'unders and overs'.

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This tax issue is causing problems for multiple FSC members that have been discouraged from setting up new funds because of the problems with the start-up concession. This is clearly discouraging new entry and competition in the funds management industry. To address this issue, the FSC proposes an appropriate lengthening of the concession with appropriate safeguards.

The FSC **recommends** a change to the Managed Investment Trust (**MIT**) start-up concession from two to five years, with the extended period available to managed funds that are being actively marketed with the intention that the MIT requirements will be satisfied.

6.1.2 Financial services law

As discussed in Section 4.1.2 above, the FSC made a submission[44] to the ALRC current review of financial services law and we made a number of recommendations that will simplify and clarify the operation of the law, and should reduce or remove unnecessary red tape in the financial services regulatory infrastructure.

Some relevant recommendations the FSC made as part of that process include:

- Personal advice should be defined in legislation as advice that in fact considers the personal circumstances of an individual consumer.
    - This recommendation addresses the concern that recent court cases have substantially expanded the scope of personal advice – noting the costs of complying with the requirements of personal advice are high, and there are large penalties applying where personal advice is provided but all the regulatory steps are not followed.
- Remove the power to amend relevant provisions of Chapter 7 of the Corporations Act by regulation or other legislative instrument, particularly where notional provisions add obligations or conditional obligations not passed by Parliament. However, the FSC believes that the power to grant exemptions and exclusions from obligations in Chapter 7 of the Act needs to be retained.

[44] See: https://fsc.org.au/resources/2436-fsc-submission-alrc-interim-report-a/file