15 September 2017

Competition in Australia's Financial System Inquiry

Ms Rosalyn Bell
Assistant Commissioner
Productivity Commission
GPO Box 1428
CANBERRA CITY ACT 2601

BY EMAIL: financial.system@pc.gov.au

Dear Ms Bell

The Financial Services Council welcomes the opportunity to make a submission regarding the level of competition within the Australian financial system.

The Financial Services Council (FSC) has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $2.7 trillion on behalf of 13 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 promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

While we are proud supporters of the existing levels of competition within the Australian financial services sector, we are of the view that more can be done to further this aim. We respectfully submit our key views in this regard over the following pages.

Should you wish to discuss this submission further, please contact me

Yours sincerely,

Catherine Chivers
Policy Manager - Investment and Global Markets

Introduction

Broadly speaking, competition can already be said to exist within the financial services sector. Within the Australian funds management, insurance, financial planning and wider banking sector (investment, business, personal) a variety of products and services can be accessed by consumers, at different pricing points.

Within the broader financial services sector, vertical and/or horizontal integration can actually provide real benefits to consumers due to the broad nature of services offered as a 'one-stop shop', which means streamlined access to sophisticated advice, products and services that can be tailored to meet the totality of the consumer's needs by an adviser who acts as the central advice co-ordinator as well as the key client contact point.

This then enables the consumer to access financial planning, mortgage, credit, insurance, superannuation/SMSF, banking, tax/accounting/SMSF compliance, legal advice (e.g. estate planning) and/or professional trustee services (e.g. acting as executor/administrator for a deceased estate, attorney and/or professional trustee) all without having to explain/provide the same personal information repeatedly, which they would be required to do if they used different service providers.

This occurs because credit, life insurance, trustee service providers, lawyers, accountants and financial advisers are all required either as part of appropriately discharging their professional responsibilities as part of their relevant professional body membership and/or as part of the business policies of their employer/licensee to ensure that they appropriately 'know their client' and be able to show that the advice, services or products provided are at least appropriate.

Further, in the context of retail personal financial advice provided through an AFSL holder, there is a statutory 'best interests' duty must be met, as well as a host of requirements surrounding the actual provision of advice (e.g. provision of a FSG and Record of Advice or Statement of Advice to the client within the required timeframe, disclosure of fees/charges etc.) which must be met.

In addition and in varying ways, ASIC, APRA, the TPB and the ATO all serve to regulate the various advice/product/service providers within the broader financial services sector. Finally, there are industry associations such as the FSC, FPA, CAANZ, CPA Australia and the various Law Societies nationally which impose further professional responsibilities and standards on their members.

Despite this, it is acknowledged that depending on the degree of vertical and/or horizontal integration which may be present within the relevant industry sub-sector, such integration may in and of itself also serve to effectively act as a deterrent or barrier to entry for new industry participants, as an unintended consequence.

However, such integration acting as a deterrent or barrier to entry in and of itself is not necessarily a bad thing – as it encourages potential industry participants to carefully consider their operating model and whether such a business opportunity is a viable long-term proposition, which in turn assists with ensuring the sustainability of that relevant industry segment. Indeed, ensuring the sustainability of the various elements that make up the Australian financial services sector is but one of many key ways that consumer interests can be maintained over the longer term.

Presently, there already exists a large degree of legislative oversight of the financial services sector which can also be interpreted as providing a form of barrier to entry to organisations seeking to enter the Australian financial services sector. Technology is already going some way to work-around such deterrents or barriers, and a practical application of Moore's Law would appear to indicate that such a trajectory will be maintained for the foreseeable future, with associated downward price adjustments as time goes by.

In a general sense though, it is important to bear in mind that many of these oversight functions also serve to safeguard the interests of consumers and the financial services sector should expect that where it fails to self-regulate in a way that meets community expectations, a government and parliament, of any persuasion, would rightly step in with legislation to ensure consumers are always put first.

We note that the *Financial System Inquiry* (FSI) which was released in December 2014, contains a number of observations around the effectiveness of the overall Australian financial system. While the overarching theme outlined in the Interim report is that …'many areas of the financial system are operating effectively and do not require substantial change', there are some policy areas which nevertheless do merit further evaluation.

Here at the FSC, we are proud supporters of the existing levels of competition within the Australian financial services sector, though we also agree that there remains some policy areas where more can be done to further this aim. These policy areas can be broadly grouped as:

1. Removal of barriers to innovation/competition generally
2. Life insurance related matters
3. Managed Investment Scheme/Investor Directed Portfolio Scheme issues, and
4. Enhanced ability for the export of Australian financial services generally

Removal of barriers to innovation/competition

It should be noted that competition serves as a key driver of innovation, and for this reason regulation needs to be developed in such a way that it doesn't stifle innovation as an unintended consequence. Importantly, innovation can occur in a number of ways – and not just in the form of 'start-ups'. For this reason it is important to ensure that government innovation policy should be developed in such a way so as to ensure a level playing field for innovation/competition to occur equally amongst both 'start-ups' as well as existing industry players.

Removing (or at least streamlining) the impact of barriers to innovation/competition within the financial services industry will serve to increase the nimbleness of industry all other things remaining equal. Areas of possible reform that need reform are the:

- presence of federal and state taxes – in particular the existing corporate tax and withholding tax regimes, and
- presence of regulatory 'red tape' more broadly – e.g. rigid and lengthy disclosure documents, which can be off-putting to the average consumer, leading to them being unread/unused

The pressing need for withholding tax reform remains ever-present

A core notion of competition is that from a policy perspective, it is only truly effective where it occurs in a way where all participants have equal treatment.

If one part of the market is hampered by higher taxes then they are unable to compete fairly; and the other sectors of the market have an unfair advantage. Those facing lower taxes will have a reduced incentive to innovate and increase productivity and greater incentive to take windfall profits/rents; while those facing higher taxes will be smaller in size, compounding the higher costs because they will have reduced economies of scale.

Previous analysis by the FSC of Australia's current withholding tax settings suggested that:
- Australia's headline rates are high
- Australia's actual taxation rates are significantly lower than the headline rates, where taxation treaties exist
- Taxable Australian real property is the main focus of taxation, through the Managed Investment Trust fund payment withholding tax and the proposed foreign resident capital gains withholding tax
- Fully franked dividends are not taxed, and
- Exemptions exist for gains from 'portfolio' holdings of Australian assets (e.g. holdings of less than 10%), and for certain fixed interest securities.

Two broad subsequent observations arise from this analysis:
1. Australia's headline taxation rates do not reflect the actual rates of taxation, and
2. Not all Australian sourced income received by foreign investors is taxed.

The FSC submits that the current state of Australia's withholding tax rates will not be marketable in the competitive environment that the recent draft Asia Region Funds Passport (ARFP) legislation seeks to create. Furthermore, we submit that these arrangements are not marketable in any ARFP jurisdiction and are not globally competitive or congruent with Australia's aspirations of becoming a global financial centre and exporting fund management services to the rest of the world and in particular Asia.

At a high level we believe complexity of Australia's non-resident withholding tax regime is a function of there being: multiple rates; complexity and difficulty of determining appropriate rate; no overarching consistent principle of application; and relatively more simplistic approaches in competitor jurisdictions, by that we mean a zero withholding tax rate.

Competitive threats are real. Over time, Singaporean domiciled funds could grow to a point where economies of scale come into play. This may result in a greater number of fund managers choosing to service Australian investors through their Singaporean domiciled funds, rather than an Australian domiciled fund – a move which will effectively reduce competition domestically.

The ARFP is focussed on retail clients. It will be necessary for foreign investors located in other Passport jurisdictions to receive simple and clear tax advice regarding the consequences of investing in an Australian Passport fund. It is hard to see how this can be achieved in the current environment.

From a tax perspective, any investment fund structure should meet two key criteria.

First, it should be tax neutral, i.e. as an investment fund essentially operates as a pooling vehicle it should not expose investors to more burdensome taxation than if they were to invest directly.

Generally, tax neutrality of a fund structure means the following:
- no taxation at the level of the fund itself, and
- no taxation on distributions from the fund to its investors in the location of the fund, and
- it should provide certainty of taxation, i.e. it should be possible to determine the tax consequences at every level, from income from investments to the distributions to investors.

Second, the FSC propose that the ARFP should have a flat and simple non-resident withholding tax rate for Australian sourced income, and a rate of zero makes more sense if Australia is to truly compete rather than merely catch-up.

The ARFP regime presents a significant opportunity for Australian funds to access new foreign capital in an ultra-competitive environment so we believe that a bolder response is required.

Australia currently earns zero non-resident withholding tax revenue from ARFP jurisdictions with respect to transferable security investments such as bonds and equities, as it is currently not possible to market such product to retail customers. To not provide a zero rate would place Australian domiciled fund managers at a significant disadvantage and, over time, allow international competitors to erode the scale advantages our domestic industry currently holds relative to other ARFP participating countries.

Specifically, the FSC recommend that:

1. At a minimum, the non-resident withholding rate should be set to zero for all eligible Asian Region Fund Passport products, and
2. In conjunction with recommendation 1, where a nil withholding tax rate is currently applied to Australian source income this should be maintained, and for Australian source income where a rate does apply (excluding taxable Australian real property) a flat withholding tax rate of 7.5% should be applied, and
3. The Government commit to reduce the flat withholding tax rate of 7.5% introduced in recommendation 2 over time towards an internationally competitive rate for a financial services centre.

International taxation competitiveness must remain a key policy focus

International competitiveness needs to be considered with respect to our aspirations to be a regional, if not global financial centre.

The 2009 Johnson Review noted:

> *"Australia has arguably the most efficient and competitive full service financial sector in the Asia-Pacific region. It is strong, well-regulated and highly regarded around the world."*
>
> *"Yet our exports and imports of financial services are low by international standards. Our funds management sector, one of the largest and most sophisticated in the world, manages only a small volume of funds sourced from offshore. Withholding tax settings contribute to this lack of international competitiveness. "*[1]

These observations remain true today.

Treasurer Scott Morrison has consistently noted a pragmatic and sensible approach to budget considerations with respect to international competitiveness, noting on several occasions:

> *"In the 45th parliament, it's about getting things done, and you've heard me say often and the Prime Minister, that 80 per cent of something is better than 100 per cent of nothing"*

If withholding taxes are not set at a competitive rate which is determined in the appropriate international context, Australia will receive 100% of nothing, and miss out on revenue, jobs and growth of our asset management industry.

We also believe the element of simplicity needs to be considered in an appropriate context. A single rate would be simpler. However, a single rate at an uncompetitive rate would yield no advantage.

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[1] http://www.theaustralian.com.au/national-affairs/politicsnow-live-from-canberra-senate-house-of-reps/news-story/599b37d0b304e32fb2ba6d243c9564a8

For retail investors in foreign jurisdictions, where they may be unable to get access to advice on foreign tax jurisdictions, simplicity in rate is essential. However, it needs to be the right rate – an internationally competitive rate.

Discounts to headline withholding tax rates should not be seen as 'lost revenue' or 'distortions' but rather as a pricing decision made by the government to ensure Australian managers are not at a competitive disadvantage compared to their peers in the ARFP regime.

International competitiveness needs to be considered with respect to our aspirations to be a regional, if not global financial centre. A rate of zero makes more sense if Australia is to truly compete rather than merely catch-up.

However, we recommend that a rate of zero only be applied to ARFP products, and that a rate of 7.5% be applied to non ARFP products - both of which should be done in a way that excludes Australian source real property income.

The revenue costs to this reform are insubstantial, while the economic benefits could be substantial. Australia only collected $5.7m of non-resident withholding taxes from fixed trust according to ATO statistics in 2013-14. Using conservative assumptions, we estimate that for every $1 billion in additional funds under management sourced from offshore investors, corporate tax receipts alone would increase by $1.8m, suggesting we would only need to attract an additional $3.2 billion in offshore funds under management globally from a $US 71.4 trillion dollar industry (A$ 94.9 trillion)[2].

Research by Deloitte Access Economics for the FSC found that if Australia could grow overseas-sourced funds under management equal to that of Hong Kong over the next decade, our GDP would grow by more than $4.2 billion, tax revenue would increase by $1.2 billion and nearly 10,000 jobs would be created.

Further, Australia's withholding tax regime is extremely complicated and has high headline rates. The rates applying to different types of income are based on a combination of international tax treaty rules, domestic taxation rules, and the character (or type) of income being generated.

Regardless of fees (which are we note are subject to market forces of competition internationally), the complexity of the Australian withholding tax system will put Australian managers at a competitive disadvantage generally (and especially within an ARFP world), where other economies offer lower rates and simpler regimes for investors in their collective investment vehicles. Singapore for example, does not impose withholding tax on distributions received by foreign investors investing into Singapore based funds.

The complex nature of Australia's withholding tax rules, and the interactions with tax treaty rules, will mean that disclosure of possible tax consequences for foreign investors in a simple and easy to understand manner will be very difficult.

Having to identify potential high headline rates and then explain how different types of income are levied different rates of withholding, as well as potential reductions in headline rates in certain

[2] Boston Consulting Group (2016), Global Asset Management 2016 - Doubling down on data, http://www.agefi.fr/sites/agefi.fr/files/fichiers/2016/07/bcg-doubling-down-on-data-july-2016_tcm80-2113701.pdf, accessed 7 September 2017

circumstances, poses a distinct disadvantage for Australian fund managers and financial planning organisations.

Possible need to consider broad-based corporate tax reform

As Australia becomes increasingly integrated with global capital markets, there is also a question of whether the corporate tax regime, particularly the dividend imputation system, is effective in reducing the cost of capital in Australia. The dividend imputation system creates a bias for individuals and institutional investors (including superannuation funds) to invest in domestic equities, and it may be a contributing factor to the lack of a deep domestic corporate bond market in Australia.

We believe that the primary focus of tax reform within the Australian jurisdiction should be to fix the taxation mix so that it improves economic growth, improves our international competitiveness, promotes investment and hard work, and raises the productivity of the country. Such a package of tax reform could be revenue neutral and still improve the medium term fiscal sustainability of budgets of all levels of government.

Competition within the Australian Life Insurance industry

Key issues affecting the Australian life insurance industry which we would especially like to see resolved are listed below.

1. Current legislative arrangements preventing life insurers from offering targeted rehabilitation benefits

The Commonwealth Government has clearly articulated that boosting workforce participation is a key priority for both economic and social reasons. For example, in the 2014-15 Budget Speech, the Treasurer the Hon. J. B. Hockey MP noted:

> *"I say to the Australian people, to build a workforce for the future, those who can work, should work. The benefits of work go far beyond your weekly pay packet. Work gives people a sense of self, and work helps to build a sense of community."*

The longer an individual is away from work can significantly reduce their likelihood of returning to work which can result in a negative effect on the individual and their family. This is because the longer a person is away from work the higher the likelihood of poorer physical and mental health culminating in more permanent disability, removing them from the workforce. For example, according to the Australasian Faculty of Occupational and Environmental Medicine, if a person is off work for 70 days their probability of returning to work reduces to 35 per cent.

Private personal disability income insurance is a means for individuals to protect themselves from economic losses that arise from both mental and physical disability. However, only viewing this type of insurance as providing income protection ignores the wider benefits that this insurance could provide to consumers, society and public finances.

Current legislative arrangements prevent life insurers from offering targeted rehabilitation benefits in certain circumstances, even when they are considered by the insurer to be relevant, appropriate and necessary to rehabilitate the claimant under a continuous disability policy. Specifically, life insurers wish to make targeted rehabilitation payments for medical treatment or therapy that they determine to be relevant, appropriate and necessary to return the claimant to work.

If these restrictions were removed, as proposed by this submission, life insurers would be able to use more effective early claim intervention practices through offering rehabilitation benefits.

This would increase an injured person's probability of successful rehabilitation relative to the status quo.

Additionally, the *Life Insurance Act 1995*, *Private Health Insurance Act 2007*, *Private Health Insurance (Health Insurance Business) Rules 2013, Health Insurance Act 1973* and S*uperannuation Industry (Supervision) Regulations 1994 (Cth)* interact in such a way that life insurers are not permitted to provide a benefit to a claimant under a continuous disability policy for treatment costs where either a corresponding Medicare benefit is payable or where the treatment is a hospital treatment or general treatment (and is not otherwise excluded from the concept of a health insurance business).

This restriction applies regardless of whether the Medicare or Private Health Insurance benefit is exhausted, meaning that any gap in costs after reimbursement under a private health insurance policy or receipt of a Medicare benefit will not be paid.

This is a perverse outcome for the individual. Providing flexibility around circumstances in which life insurers may pay medical and other such treatment costs in disability insurance claims would enable life insurers to better facilitate early claims intervention. This would allow payment of medical treatment in circumstances where treatment supports and aids the early return to work.

Details of legislative restrictions and required changes

Life Insurance

Life insurers are regulated by APRA under the Life Act. Section 234 provides that a life company must not intentionally carry on any insurance business other than life insurance business. Life insurance business is defined in section 11 as, among other things, the issuing of life policies. Life policies include disability policies that are 'continuous disability policies' as defined in section 9A of the Act. Life insurers may provide disability insurance that complies with this definition, and typically do so in the form of total and permanent disability insurance (TPD), income protection insurance for temporary incapacity, and trauma or critical illness benefits for specified illnesses, conditions or injuries.

Section 9A provides that a contract of insurance entered into in the course of carrying on health insurance business (as defined in in Division 121 of the Private Health Insurance Act 2007 (Cth) (**PHI Act**), considered below) is not a continuous disability policy. A life company therefore cannot currently provide rehabilitation benefits to the extent this would involve carrying on health insurance business.

APRA has power under section 12A of the Life Act to declare that other types of insurance business carried on by a life company are to be treated as life insurance business. However, APRA may not make such a declaration in respect of health insurance business.

Health Insurance

Section 126 of the Health Insurance Act 1973 (Cth) (**Health Insurance Act**) prohibits a person from providing insurance that covers liability to pay a medical expense in respect of the rendering in Australia of a professional service for which a Medicare benefit is payable. This restriction applies regardless of whether the person's ability to claim a Medicare or private health insurance benefit for the liability is exhausted. The key exception is for complying health insurance policies entered into by a private health insurer that cover hospital treatment or hospital-substitute treatment. No exception applies for benefits paid by life companies.

Section 10 of the Private Health Insurance (Prudential Supervision) Act 2015 (Cth) (**PHI Prudential Supervision Act**) prohibits a person from carrying on a health insurance business if the person is not a private health insurer. Health insurance business is defined in Division 121 of the PHI Act to include the business of undertaking liability by way of insurance that relates in specified ways to hospital treatment or general treatment as defined in the same Act. Again, no exception is provided for benefits provided by life companies.

Hospital treatment is defined in section 121.5 of the PHI Act as treatment (including goods and services) that is intended to manage a disease, injury or condition, and is provided either at a hospital, or with the direct involvement of a hospital. General treatment is defined in section 121.10 of the Act as treatment (including goods and services) that is intended to manage or prevent a disease, injury or condition and is not a hospital treatment. This encompasses many of the services that are likely to be necessary for the management and rehabilitation of illnesses and injuries that result in disability.

A number of insurances and benefits are excluded from the definition of health insurance business by the Private Health Insurance (Health Insurance Business) Rules 2017 (Cth) (**PHI Business Rules**). Relevantly, Rule 16 of the PHI Business Rules excludes death and certain disability benefits. Many of the excluded benefits satisfy the criteria for 'continuous disability policies' under the Life Act. The exclusion applies, for example, to income replacement benefits and certain lump sum benefits payable on the occurrence of events defined in the policy (such as trauma benefits).

We consider that there would be merit in expanding the exclusions from health insurance business so that life companies are also permitted to provide benefits for other types of rehabilitation expenses. This could be done by amending the PHI Business Rules so that the exclusions under rule 16 exempt benefits provided by a life company to cover medical treatment costs where the company considers that the medical treatment will assist in the rehabilitation of a claimant under a policy.

The economic and social benefits of increasing rehabilitation rates

Being off work can significantly reduce the likelihood of an injured person returning to work. Research has shown that people who do not work are at risk of poorer physical and mental health. They are more likely to be socially isolated and experience low self-confidence. They are at a greater risk of suicide and death. All of these factors have flow on effects to society, impacting families and communities.

If a person is off work for:

- 20 days, the chance of ever getting back to work is 70 per cent
- 45 days, the chance of ever getting back to work is 50 per cent
- 70 days, the chance of ever getting back to work is 35 per cent.[3]

The benefits of higher return to work rates that would eventuate from a targeted adjustment to legislative settings to allow life insurers more flexibility with respect to making rehabilitation payments would promote a more sustainable life insurance industry.

Increased return to work rates would translate to a lower claims cost for a disability income protection policy on a net present value basis and would allow insurers to have more stable premiums on products.

This potential improvement in the NPV of an insurance policy over its life would incentivise life insurers to invest in more active rehabilitation strategies which would unlock positive externalities.

[3] Royal Australasian College of Physicians (2011), Realising the Health Benefits of Work – Position statement of the Australasian Faculty of Occupational and Environmental Medicine, https://www.racp.edu.au/docs/default-source/advocacy-library/realising-the-health-benefits-of-work.pdf accessed 7 September 2017.

For individuals, higher return to work rates leads to a better outcome on a NPV of lifetime income basis. It would also lead to better social outcomes for individuals.

For government, higher return to work rates will reduce the fiscal costs of the Disability Support Pension and the National Insurance Disability Scheme. By definition, higher return to work rates will translate into higher workforce participation which is a key government objective at a time when the population is aging and the Australian workforce is shrinking.

2. Introduce a mechanism to facilitate the rationalisation of legacy products in the life insurance and managed investment sectors

A comprehensive product rationalisation regime would provide better consumer outcomes by creating greater efficiency in the industry and access to more modern and relevant offers for consumers. Indeed, the current mechanism for rationalising managed investment schemes, life insurance legacy products and other related products or structures is too difficult and expensive. As a result consumers remain in financial products that suffer from a higher cost base and carry operational risk from outdated technology and products that are difficult to support.

The FSC surveyed members to develop conservative estimates of the benefits that an effective product rationalisation regime would deliver in the near term:

- 38 individual IT systems could be closed, of 79 legacy IT systems across the sample
- 286 life products and 77 managed investment schemes could be closed, and
- $22.6 billion in funds under management could be transferred to contemporary products.

FSC members forecast that through these changes they could achieve $94 million in cost reductions over the near term through a staged rationalisation program, which would result in a more efficient and sustainable industry.

Although a financial product may be closed and is of low scale, it still needs a broad range of services similar to those provided to an on-sale product, including (but not limited to): technology, accounting, audit, disclosure, legal, actuarial, product and tax services as well as being supported by an administration team and front line call centre staff who need to remain trained on the particular product.

Continuing to manage bespoke financial products that are highly aged and whose promotion predates the majority of employees' tenure is a significant challenge for most financial services companies. This is both from an operational risk perspective but also in maintaining aged systems that are typically less agile or economical to run and keep updated (including for regulatory change), less able to support a modern service to customers and more challenging to locate appropriately skilled support staff.

For example, while each product within a particular group shares certain characteristics, there are typically individual differences which must be monitored to ensure promises made to customers are met and this layering of iterative legacy product complexity is a material compliance burden, a barrier to organisational change and diverts resources from more customer value added activity.
If the problem isn't fixed, providers will not be able to rationalise products in the overall interests of consumers, and it is going to become increasingly risky and expensive to administer products.

Consumers would become worse off due to increasing costs (exacerbating underinsurance) and reduced service, and also run the risk of being trapped in out of date products – products which may have become obsolete as a result of changing tax, legal and social security regimes and also shifts in consumer sentiment and demand. Furthermore, it is hard for product issuers to justify investment in new tools for legacy products and other enhancements beyond what is legally required. Because of this consumers of legacy products lose out on that upside benefit. For example, a legacy product will not typically offer online access and other digital features that are being built into new products.

There is a range of tax implications that flow from activities designed to rationalise legacy products. As a general rule the FSC's position is that the tax attributes of the original vehicle should be able to roll over to the destination vehicle.

3. Other suggested amendments to the Life Insurance Act 1995 (Cth)

The FSC also suggest other miscellaneous amendments, which should serve to improve efficiencies within the Life insurance sector below:

ISSUE	SECTION	SUGGESTED AMENDMENT
Life insurance definition to include policies less than three years duration	9 and 9A	Amend to allow for shorted duration to be considered life insurance
Annuities of any duration to be considered life insurance	9(1)(d)	Amend Life Regs to include annuities of any duration
APRA declaration of annuities as life insurance	12A	Amend to allow APRA to declare annuity characteristics as life insurance
Mortgaging assets of a statutory fund	38(3)	Remove restrictions
Requirement for endorsement of assignment of policy	200	Remove this requirement
Limits for payment without probate or administration	211 and 212	Need to be increased from $50,000 to $200,000
Appointment of life insured as policy owner following death of original policy owner	213	Endorsement requirement should be removed and limits need to be increased from $50,000 to $200,000
Unclaimed monies requirements	216	Streamline the payment mechanism so ASIC pays claimant directly
Move from paper to electronic	221-225	Repeal sections which are in place to deal with a single paper policy document rather than An electronic record
Requirements to keep registers of policies by State	226 and 227	Remove exclusion of the Life Act from the *Electronic Transactions Act 1999* (Cth)
War exclusion	229	Remove requirement for written endorsement of policy document for exclusion

4. Reduced reliance on stamp duties on Life insurance

The state governments currently rely heavily on raising their revenues through comparatively less efficient taxes (conveyancing, insurance and motor vehicle duties) that contribute to 42% of total state taxation revenue.

They should seek to increase the share of revenue raised from more efficient taxes (such as a broad based land tax), broadening the payroll tax and reduce the use of less efficient taxes such as stamp duties on insurance, through taxation reform. Moreover, the impact of abolishing stamp duties for life insurance on total state revenue is minimal, since these duties contribute only a small share of total state revenue in all states. While recent reforms in the ACT have led to reduced stamp duties paid on life insurance policies and life insurance policy riders, changes in Victoria and South Australia have had the effect of increasing taxes on life insurance products.

Inefficient state transaction taxes are a drag on our economy to the order of $12 billion per annum. These taxes drive perverse outcomes such as discouraging people from taking out insurance and are amongst the most distortionary and inefficient in the economy. Different tax collection regimes in each state are an unnecessary burden on business. The combination of tax and compliance costs ultimately raises the price of life insurance, making life insurance less affordable for the average Australian.

The FSC recommends that life insurance stamp duties should be abolished as part of the Federal Government's Tax White Paper process, with the foregone revenue replaced by a more efficient revenue stream, such as the GST.

5. Regulatory Constraints on Life insurers to support necessary rehabilitation and medical expenses

Private personal disability income insurance is a means for individuals to protect themselves from economic losses that arise from both mental and physical disability. However, only viewing this type of insurance as providing income protection ignores the wider benefits that this insurance could provide to consumers, society and public finances.

Current legislative arrangements (Private Health Insurance Act 2007 and Health Insurance Act 1973) prevent life insurers from offering targeted rehabilitation benefits in certain circumstances, even when they are considered by the insurer to be relevant, appropriate and necessary to rehabilitate the claimant under a continuous disability policy.

If these restrictions were removed, life insurers would be able to use more effectively early claim intervention practices through offering rehabilitation benefits. This would increase an injured person's probability of successful rehabilitation relative to the status quo.

6. Proposed Reforms to Life Insurance Claims – late notified claims

Premium increases have been necessitated in part by the inability of life insurers to accurately price group life insurance and this has meant that in many cases, consumers are paying more of their superannuation savings for life insurance protection. Life insurers need to be able to manage the risk of claims being lodged later than expected to reduce pricing volatility and provide greater certainty in the market and reduce premiums in the long term.

Ensuring that disability claims are notified to life insurers within a specific time period (4 years) would achieve this end. An outcome that is in the interest of all parties as early treatment and rehabilitation makes a significant difference in the ability to recover from a significant accident or illness. The current problem for life insurers is that there is no notification period in life insurance policies (Section 54 of the Insurance Contracts Act 1984).

Competition within Australian Managed Investment Schemes and Investor Directed Portfolio Services

Many organisations operate managed investment schemes (registered or unregistered) which, due to their size or numbers of members are no longer efficient to operate. This may arise because a scheme is closed to new members and over time redemptions have reduced the size of the scheme (but the cost base has stayed the same or increased) or because mergers have resulted in duplication in the investment strategies of funds in the group.

For example, post-merger a group may operate two emerging markets funds and it would be more efficient (and cost savings could be passed on to investors) if the funds could be merged.
It is difficult under the current legal framework to transfer investors from inefficient schemes to more modern or more sufficient schemes. For registered and unregistered schemes generally a 'trust scheme' is needed which requires meetings to be convened and generally requires applications to court for judicial advice, the outcomes of which are uncertain and the costs of which can be significant.

If transfers are not viable the only other real alternative is termination. Again, the outcome may be uncertain and the costs may be significant as a meeting may be required to amend the trust deed or seek member approval (a meeting is mandated by the Corporations Act for a registered scheme) and judicial advice may be needed. The termination of the fund may also crystallise any capital gains for the investor.

The FSC recommends that:

- the transfer of all the members from a legacy scheme (e.g. a scheme that is economically inefficient or out-dated) to another fund be permitted where the responsible entity or trustee considers on reasonable grounds that those transfers are in the interests of those members as a whole, and
- a more streamlined regulatory regime be introduced for the transfer of REs within a corporate group.

Enhanced ability to export Australian financial services

We've started the process…

The Johnson Review noted that Australia has arguably the most sophisticated and advanced financial sector in the region and that there are significant opportunities to expand our exports to the region from a very low base. The enhanced ability to export financial services effectively serves to promote additional levels of competition within the domestic arena, as a natural by-product.

The Johnson Report outlined four areas of policy focus:

1. competitive taxation rates
2. introduction of a varied Corporate Collective Investment Vehicle (CCIV) regime consisting of a broader range of CCIVs
3. tax certainty for offshore investors including introduction of an Investment Manager Regime (IMR), and
4. regulatory architecture for exporting (such as through the ARFP, Free Trade Agreements or Mutual Recognition).

Pleasingly, the ARFP and CCIV recommendations of the review are now well on their way to implementation following the recent release of draft legislation and associated Explanatory Memorandums in this space.

…but there's still more work to be done

However there are several Australian domestic regulatory reforms needed to ensure it succeeds, and as yet broadbased Government coordination of policy, regulation and international competitiveness issues have not occurred in Australia. In particular, the Free Trade Agreement process in Australia has not focussed on implementation to ensure market access commitments are actually made available to Australian firms.

By implementation, we typically mean establishing mutual recognition between regulators so financial services firms can export to offshore markets through licencing equivalency.

As mentioned previously in this submission, Australia requires a greater focus on tax and regulatory competitiveness issues as well as ensuring the provision of the necessary architecture to allow Australian firms to export financial services.

The Financial System Inquiry final report quoted 'Australia's financial sector is less open and internationally integrated than it could be now – and then it will need to be in the future'[4]. The FSC agrees with this statement and urges the PC to provide recommendations in its report to increase Australia's international integration.

[4] Financial System Inquiry Final Report 2014, page 20