Submission to the Senate Economics Committee – FOFA Legislation from Mervin C Reed FAICD.

Introduction:

The package of bills known as the FOFA legislation has had an interesting gestation.

The bill's propose to interfere in the marketplace in a number of areas, they propose to limit the capacity for financial planners and advisors to deliver services to clients, and a did propose until parts of the legislation were stripped out, to make it mandatory that Financial Advisers and Planners act in the best interests of their clients. This has subsequently been recast into the second FOFA bill with the appropriate carve out for industry superannuation funds.

In essence these bills are anti-competitive and current structure and intent.

Presently the bills have been referred to both the PJC and the Senate economics committee for consideration. There has been active debate and disclosure at the recent PJC hearings in Sydney.

My submission will follow the requirements of the committee and is as follows:

Regulatory impact statements:

These bills have been put together without any regulatory impact statements being undertaken. There are a number of ways in regulatory impact actions by government are able to be measured.

The first of these are the costs to be persons in the private sector component of the economy that have to deliver the regulation. It is quite rare for government to deliver regulation without understanding its impact upon the economy.

The costs borne by those people the law requires to implement the measures, can be determined both from the point of view of how much time they take in addition to their normal activities completing various steps, for stages that are required under the legislation or regulations, to meet the outcome determined by government.

These measurements are real, and relate to how many hours at what level of salary expense is committed to each stage of the task.

How much for example, does it cost to rearrange a database in order to enable the organisation supplying the financial service to contact the customer or client when required to do so by the legislation.

Assuming that the hours and programming dollar costs have been quantified, how much additional computer time is required at what cost per hour, is to be added to the normal computer time requirements of operating the business, and will this provide constraints to the business or will the business be required to expand additional funds on more computer equipment and communication links and at what cost.?

This then proceeds to the actual costs of the interaction between the client and the financial services organisation, the adviser for planner, where the costs will be substantial.

Firstly there will be the telecommunications and mailing costs which when multiplied by thousands of clients per month nationally, will increase costs ex-potentially. So the cost structure here would be what type of communication will be sent to the client, how will be formatted, and what will it need to say.

Of course depending on the type of client, their level of financial literacy, and their capacity to even understand what is required, the message may have to be altered manually for each client.

The question of language barriers has not even been addressed by this legislation.

The voice communication to the client will be required under the legislation, compelling the financial adviser or financial planner, herself or himself to speak with the client outside of the normal client contact arrangements, which can be quarterly, six monthly, or yearly.

This will need to be costed with the adviser/planner time being in the order of around $200 per hour.

There is also the time to the client be considered, as most clients are employed, or earn a salary on a self employed basis and therefore have to *give up that time* to meet the outcome requirements of the legislation or regulations.

The cost to the client in time is equally as important in the impact statement for the legislation and regulations, as is the cost to implement.

Lastly there will be the hardcopy linkage that will be needed to meet the legislative outcomes with a proof being on the file and this will amount to approximately a further 35 to 40 min of staff time to prepare, dispatch, follow-up, and have returned the appropriate certification from the client.

There is also the client time to be costed in relation to the certification process.

There appears to be at this stage **no proper algorithm** having been developed by the Department of Treasury, determined with active and licensed financial advisers from large medium and small organisations for accuracy, and then used to cost the series of regulatory changes in modular form.

This process if it has not been done will render any calculation meaningless.

Once the costs of this process have been provided to the Treasurer and to the Parliament, then there will have been proper disclosure.

Impacts:

I now turn to the fundamental nature of this policy change and the need for the government to be concerned in a number of areas as to the impact of the changes:

These impacts are focused on precise areas.

The first is the overall quantum of funds being contributed to superannuation by retirees and intending retirees.

Secondly there is the impact of the lack of support been shown by the government for people making provision to their retirement accounts.

This is especially true with the messing around with contribution caps. Such is the confusion that proper long-term planning is now not possible, as the certainty has been withdrawn. Policy formation in this area can be readily considered to have been a failure.

The third impact will be the diversion of asset allocations from equities to property.

The results of these impacts will be:

1. **Revenue Losses**

Superannuation provides substantial revenues to the Federal budget and some of this revenue both for the 2012 – 13 fiscal year and for future years will now be impacted.

Revenue losses will be permanent and substantial in the area of the taxation of superannuation earnings as both platform accounts, wrap accounts, and self managed super funds will move assets from Australian and international equities into local direct property.

Given the legislated capacity to gear local direct property within the superannuation funds, the revenue losses will be relatively immediate as the funds are moved from equities and cash to direct property and the superannuation accounts moved more to break even accounting outcomes, in the accumulation phase.

Hence super funds will pay no tax on the earnings as there will not be any earnings in the next 5 to 10 years. The government will be made to pay a heavy price.

2. **Lower level of superannuation contributions.**

This leads to the second area of revenue losses generated by a lower overall quantum of funds being placed into the superannuation system as confidence by advisers, and planners as well as clients is reduced in the government, by the nature its policy changes to superannuation.

The pronouncements by certain sectors of the industry superannuation movement that future superannuation pensions will be paid as annuities, and these will be fixed, has led some clients already to reconsider their investment options.

The fundamental fact is that people will not be told what to do with your own money.

As much as government thinks they can control this, the more money flows elsewhere.

Notwithstanding the proposed increase of SGC contributions over time, it is apparent there will be a drop in revenue as a result of the FOFA bills being implemented, the increased likelihood of some constriction being placed on the withdrawal of funds in retirement which will lead to people simply reaching the age of 60 and withdrawing their funds from superannuation.

If the government tries to counter this by saying they will restrict the flow of funds from superannuation at preservation age, then people will simply stop investing in superannuation.

The result is that the government gets less revenue, as money flows into non-taxable assets in the short term. This is a very very dangerous policy that the government has embarked upon without thinking through to long-term impacts upon the superannuation policy of Australia.

The second part of the ***revenue loss that will be sustained by the government*** is in regard to contributions.

People make contributions to superannuation in order to provide for their own retirement rather than rely on the government.

Over many years the government has had a policy of encouraging this and financial advisers and planners have been the exponent of the government policy.

This is now changing whereby the government has reduced the indexation on the contribution limits and not extended the ability of people to move funds into superannuation at retirement.

The mix of retirement funding possible in the future will see more diversification into investments outside of superannuation, where self-funded retirees will pay little or no tax if these investments are adequately set in the first instance.

The lack of contributions increasing due to the pressure being applied to financial advisers and planners will see that 15% of contribution taxes, gained by the government as budget revenue, diminish.

This 15% contribution tax is a constant revenue generator for the government, essentially indexed, but you will see this diminish, as (outside of the superannuation guarantee contributions) money moves away from superannuation.

This will be further *emphasised* by the downturn in the European Economic Community, and the general slowdown in the world economy.

Superannuation is an extremely large investment in Australia and up until retirement or the rollover from the accumulation stage to the pension stage of the superannuation account, the government gains 15% of every dollar contributed and 15% of every dollar earned.

The growth revenue coming from superannuation to the Federal government is likely to reduce by 10% in 2012 – 2013, and subject to the impact on financial advisers and planners of the FOFA regulations likely to reduce further.

3. Diversion to alternative asset classes

Further revenue losses will be sustained by the Federal budget as advisers and ***planners move their clients' funds from equities to fixed interest and guaranteed income plans.***

It has been the substantial growth in capital gains tax paid on equities transactions of the past that have been the real income generator for the Federal government with superannuation.

The share market the past two years has been relatively flat and gains quite limited.

If the government is insistent upon telling financial planners how to operate their businesses, and then financial planners will not be supportive of government activities, and certainly not to the detriment of their clients, as more a more social engineering gets filtered into the superannuation system.

The primary requirement of the adviser or planner in relation to the client is to sustain their cash flows in retirement, not generate revenue for the government.

Hence the transfer of assets from the broader asset classes in equities, to fixed interest and long-term property, changes the nature of the long-term revenue generator for the Commonwealth of Australia.

Most of the Treasury officers I have met in the past do not understand that Australia and retirement income saving has a far higher proportion of equities than retirement income savings is elsewhere in the world.

By the Treasury support for these FOFA bills, they are in fact supporting a policy of lower gross revenues from superannuation going forward.

This will happen as assets are moved from the equities class to the fixed interest and property class where the rate of tax within superannuation funds achieved by the government is substantially less.

Thus the cash flow from the superannuation industry going into the Australian economy as a direct investment by way of equity participation will now diminish, and as a result companies operating within the Australian economy will find it more difficult to receive capital from shareholders, to raise capital from shareholders by corporate actions, and will certainly find borrowing more expensive as the debt swap contract prices are now going to increase.

Ultimately this will flow through to government revenue from capital gains tax in relation to the share market as the overall participation in the acquisition of equities falls per capita, the activity on the market will slow down, and thus trading will result in substantially less tax for the government.

Presently the government receives a relatively clean 15% tax in regard to funds going into superannuation.

This over-time will diminish per capita, and as the larger clients are switched into more or more self managed super funds via financial advisers and planners, to allow diversion and diversification of funds, the average rate of tax being paid by way of contribution to the funds will trend down to less than 9%, given the offsets that the funds will have in terms of taxation deductions.

There are some parts of the FOFA bills that the industry generally supports and these are well-known.

However the opt in provision and the treatment of life insurance, especially the recent Exposé of the legislation now compelling a similar opt in to all life insurance clients, whilst at the same time extending the carve out for the industry super funds, means that the impacts on the revenue will now proceed.

Specifically the opt in provision more frontload to consumers a bunch of costs that will be well identified as coming with compliments from the government. These costs will not be absorbed.

The second issue in relation to **these bills is that they are a patchwork quilt**, with various additions and deletions being added to the exposure drafts, without any financial services industry support.

It appears that the industry super funds are more intent on protecting their own business, with mandated cash flows from awards, than they are in competing on a level playing field with a private sector offering My-Super accounts.

The idea of efficiency across the financial services industry is apparently anathema to the Industry Superannuation Funds.

If the private sector has to annually re-disclose the margin made on life insurance and on fees and charges as proposed in the legislation, why doesn't the government legislate for industry super fund members can know exactly how much profit share on life insurance group plans they contributed from the payment of their life insurance premium, to the industry fund.

The industry fund should then be also compelled to provide an accounting or disclosure to each member of how these millions of dollars was spent, rather than being credited to member accounts, for the benefit of the member.

Further to this the industry fund should be required to disclose all trustee fees paid to trustees on an annual basis and there should be communicated with the annual report on the fund to each member.

The member can then determine whether the hundreds of thousands of dollars of trustee fees they are paying to trustees of the fund is good value given the fund's performance.

This would only be fair and equitable.

Summary:

The revenue impact statements for the implementation of this legislation to the revenues of the Commonwealth of Australia appear, not to have been done.

The regulatory impact statements for the financial services industry and ultimately consumers, who will pay the cost of implementation, appear not to have been done, but if they have been done, the results have not been released in full, together with all of the computational detail supporting the contentions.

Normally the Federal Department of the Treasury is prepared to support their contentions with fact. In this case it appears that this is not to be the case.

The net effect of the change in assets across the superannuation industry has not been properly assessed as to the long-term revenue impact, and as a result the forward estimates for revenue from superannuation to the Commonwealth of Australia will be substantially impacted.

Lastly the disclosure by the private sector component of the life insurance and superannuation industry is being legislated at a Micro level, but there is no disclosure at all from the Industry Superannuation Funds nor are they at all impacted by the government's legislation.

This leaves a significant component of superannuation fund member’s worse off, being unable to find out what their superannuation fund is spending their earnings on.

Whilst at the same time the same members have no understanding of the large trustee fees being paid to people that represent the interests on the boards of neither the Industry Superannuation Funds nor where these funds go.

A level playing field is required for all. The government is trying to make the market. Governments are not good at this and every time they try to do this, it ends up being a mess.

What is needed is a competitive level playing field for all.

Competition will then take care of the rest.

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