FINANCIAL SYSTEM INQUIRY

CPA Australia's submission to the Financial System Inquiry

March 2014

BE HEARD.
BE RECOGNISED.

A note from Alex Malley FCPA, Chief Executive, CPA Australia

CPA Australia welcomes this timely 'root and branch' review of Australia's financial system and applauds the Government's commitment to putting all options on the table.

Following the last comprehensive Australian financial system inquiry in 1997 Australia introduced ground breaking reforms which led to the twin peak model of financial system regulation. At the time, these robust reforms put Australia at the forefront of global financial services regulation and increased our global competitiveness.

Now, almost two decades since the 1997 Wallis Inquiry, the Australian and global environment for financial services has changed significantly, underscoring the timeliness of this review. The world has witnessed a number of major financial shocks which reverberated through Australia's financial system. These include the Asian financial crisis, the corporate collapse of HIH and the recent Global Financial Crisis (GFC). We have also seen the continued growth of Australia's superannuation industry, the continued incredible pace of globalisation, the re-emergence of Asia as a centre of global economic prosperity and influence, a growing and ageing population and increases in cross-border financial transactions.

However the most significant transformations of the last two decades have been driven by rapid advances in communication technologies that have forever changed the complexity, the speed of transactions, the contagion risk of the system, and the way that consumers, sellers and regulators all operate within the Australian and global financial services sectors.

Responding to these challenges must be a major driver for this review. In addition to increasing consumer protection and the systemic stability of the sector, the review needs to focus on improving the global competitiveness of Australia's financial services sector. By taking a global perspective this inquiry will better and more accurately reflect the changing landscape of global financial services.

CPA Australia therefore calls on this review to be just as bold as its predecessor some two decades ago, by going beyond simply examining the issues facing Australia's financial services sector today. Rather, this inquiry should lead to enhancements in Australia's robust and responsive regulatory system for tomorrow, with a focus being on reforms that will lift the global competitiveness of Australia's financial services sector and serve it well for the next 10, 15 or even 20 years. This is not a prescription for wholesale change but if the last two decades have taught us anything, we cannot rest on our laurels when it comes to ensuring the robustness of our financial systems. It will be critical if Australia is to realise the oft touted vision of becoming a financial services 'hub' in the Asian region in this, the Asian Century.

Alex Malley FCPA
Chief Executive, CPA Australia

About CPA Australia

CPA Australia is one of the world's largest accounting bodies with a membership of more than 150,000 finance, accounting and business professionals working in over 121 countries across the globe.

We have a history that stretches back to 1886, and have been actively involved in Asia since the early 1950's. We currently have nine offices in Asia and more than 35,000 members working in the region.

CPA Australia is committed to a creative engagement with governments and their agencies on behalf of members and in the broader public interest to encourage the adoption of economic and social policies that foster improvements in Australia's productivity and global competitiveness.

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The future of Australia's Financial Services Sector

Since 1996 when the Wallis inquiry was charged with examining the results of the 1980's deregulation of the Australian financial system the landscape and regulatory philosophy for global financial services has continued to evolve.

Over the past 16 years we have seen the increased gobalisation of financial markets, incredible advances in technology, the continued growth of the Australian superannuation industry as well as significant demographic changes, including the ageing of the Australian population and a more urbanised society.

Despite the recommendations of the 1997 Wallis inquiry explicitly designed with a 2010 expiry date, the same issues the sector faced then are just as relevant today.

We survived the Asian and global financial crises – so why change?

Over the last five years the Australian financial services sector has faced the best form of stress-testing available. The Global Financial Crisis (GFC) placed enormous pressure on the nation and despite significant asset write-downs and market intervention by government and the Reserve Bank, the Australian economy and the financial services sector has come out the other side extremely well, particularly when compared to many other developed nations.

Importantly, Australia's financial services institutions, for the most part, remained profitable throughout and more importantly, they remained well capitalised, which meant that access to capital was not as constrained in Australia as it was in many other parts of developed world.

The Wallis inquiry pointed to the balance that must be found between the stability of the system and efficiency in financial regulation. Despite stability being at the front of everyone's mind following a crisis, we should not forget the vital role that the financial system plays in supporting wealth creation and ensuring credit is available and affordable to those who can make the best use of it.

What the GFC illustrated was that there were no major or obvious weaknesses in the Australian regulatory structure and as such, there is no clear evidence to support the need for major reform of Australia's financial regulatory system as a whole.

However, the continued strength of Australia' superannuation industry and our growing reliance on financial advice and products are the key issues which are in need of a full and frank evaluation to make sure that Australia is well placed, both domestically and globally, now and for future generations.

Australia needs locally focused as well as global regulation

Following the GFC, key international bodies including the G20, Basel Committee on Banking Supervision, the Financial Stability Board and the International Monetary Fund were all charged with developing rules and regulations designed to create a more robustly regulated global financial system. In the circumstances, such changes were entirely appropriate.

However, Australia must always be mindful that increasingly such international regulatory agencies will be developing these rules based on the experience of the world's largest financial markets during the recent crisis, which evidence suggests was quite different to the experience of Australia and Australian firms.

Accordingly, in considering the applicability of international changes to our domestic environment, we must be ever cautious to ensure we achieve balance between the benefits of financial system stability and the high cost associated with greater regulation. Moreover, we must ensure that any international rules are suitable for Australia's needs.

That said, given Australia's relative size as a financial market and its position as a global importer of capital, Australia generally has little choice but to comply with these rules. For this reason CPA Australia supports the strong involvement of government and financial services regulators in key international fora to ensure that Australia's needs are understood and met by the changing face of global financial services regulation.

Recommendation:

CPA Australia recommends that the Council of Financial Regulators (CFR), whose role it is to contribute to the efficiency and effectiveness of financial regulation and to promote the stability of the Australian financial system, have its responsibilities extended to specifically examine advances in international regulation.

Only by being an active participant can we ensure that Australia maximise the benefits and minimise the harm of potentially inappropriate international regulation on Australia and Australian markets.

Need to balance regulatory burden with systemic stability and consumer protection

In financial services, as with other sectors of Australian business, the dead weight of regulation is a major drag on Australia's productivity and competitiveness and a disincentive to innovation in financial markets.

Therefore, it is important that any review of regulatory structure also consider reducing unnecessary regulatory burden and ensure that all proposed regulation be subject to stringent tests on its necessity, design, impact on competitiveness and consequences.

It is vital that Government intervention in the operation of markets be avoided unless there is a significant market or regulatory failure. Moreover, we must be cautious to ensure that the cost of the proposed regulation does not exceed its benefit. Regulation should only be considered if there is significant evidence of a problem, other remedies to the problem are ineffective and the proposed regulation is limited to addressing the specific problem that had been identified.

Is the twin peaks model of financial supervision still appropriate for Australia?

The twin peaks model of financial system regulation, adopted both in Australia and in The Netherlands, is designed to take the benefits and efficiencies of an Integrated Approach to regulation - where a single universal regulator is responsible for both safety and soundness oversight as well as conduct-of-business regulation for financial services businesses (the now superseded UK Financial Services Authority approach) - while addressing the conflict between competing objectives of safety and soundness regulation and consumer protection and transparency. This hybrid model, often referred to as 'regulation by objective', with the Australian Prudential Regulatory Authority (APRA) regulating deposit-taking institutions with a focus on the safety and soundness of the entities it supervises, and the Australian Securities and Investment Commission (ASIC) the business conduct regulator with responsibility for market integrity and consumer protection.

This separation of prudential regulatory oversight from conduct-of-business regulation has served Australia well. This was confirmed in a July 2007 Washington based Group of Thirty (a private non-profit international senior public and private sector policy body) review of various national supervisory and regulatory approaches, in the light of the changing global financial system. This review of 17 major national supervisory systems confirmed that while dealing with similar problems and challenges, these systems are designed and reflect the differences for these individual countries in terms of their political, cultural, economic and financial influences.

As highlighted earlier, given the current robustness and relative success of Australia's regulatory system through the GFC we therefore do not believe that wholesale regulatory change and a move away from the twin peaks regulatory approach is needed. However, while not moving away from the fundamentals of the model, the foundations on which the Wallis inquiry established the twin peaks model have changed and it is our strong view that they should be looked at in greater detail if we are to ensure that Australia's current regulatory agencies remain fit for purpose.

Are the current Australian regulators 'fit for purpose'?

The Wallis inquiry recommended against government guarantees of private companies (including deposit guarantees) to make it clear that financial institutions were not supported by the central bank. This position was based on a fear that if this guarantee was made, either implicitly or explicitly, that this would then promote greater risk taking by these institutions on the assumption that the government, or indeed Australian taxpayers, would always be there to bail them out if things turned bad.

As we are aware, this is exactly what the Reserve Bank did during the GFC by putting up an estimated $850 billion to guarantee the liabilities of private financial institutions, a further $690 billion to guarantee bank deposits, guaranteeing wholesale debts, and a raft of further measures. Given that these guarantees were put in place, and it is likely that they will be introduced again given a similar major shock to the financial system, the distinction between the Reserve Bank, which is responsible for the stability of the financial system, and the Australian

Prudential Regulation Authority, which oversees the solvency of banks and other financial institutions, may no longer be justified.

As this inquiry would be aware, in June last year the Australian Senate referred an inquiry into the performance of the Australian Securities and Investments Commission (ASIC) to the Senate Economics Reference Committee, with an expected reporting date of 30 May 2014. This inquiry received over 400 written submissions and heard a number of presentations via public hearings. CPA Australia made a detailed submission to this inquiry and appeared before the inquiry.

Our submission to that inquiry goes to the heart of our concerns regarding the appropriateness or 'fit for purpose' of ASIC as it currently stands.

ASIC has grown, both in size and responsibility since it was formed out of the Australian Securities Commission in 1998.

Currently ASIC is organised along three streams: Markets, Investors and Financial Consumers and Registry and Licensing. It could be argued that the Government should separate out the functions for investors and financial consumers from its market responsibilities. This separation would enable each new regulator to better focus on its roles and responsibilities, staff appropriately and better enforce the current regulations. An argument can be made that there are very different requirements for regulating a market to regulating individual financial products and advice.

Separating out these functions would enable there to be healthy debate and conflict between these areas and would increase the robustness of the Australian financial services sector, reducing the ability of the regulator to be 'captured' by the industry.

CPA Australia recommends that this inquiry liaise with the Senate Economics Reference Committee to gain greater insight into the work of that Inquiry and including possible reforms to Australia's primary corporate, markets and financial services regulator.

Recommendation:

CPA Australia recommends that this inquiry liaise with the Senate Economics Reference Committee to gain greater insight into, and possible reform of ASIC as Australia's primary corporate, markets and financial services regulator.

The size and influence of Australia's superannuation sector needs to be considered

Since the introduction of the Superannuation Guarantee in 1992, Australia has experienced exponential growth in the level, and influence, of the compulsory savings sector, particularly through the growth of the major superannuation funds.

According to a recent Deloitte study, the Australian superannuation system is the fourth

largest in the world with a pool of assets projected to grow to $7.6 trillion by 2033, or in real terms, from less than 100 per cent to approximately 180 per cent of Australia's GDP over the next 20 years. This raises the question – Is this sector as a whole now too big to touch?

Despite the growth in the Australian superannuation sector all sounding like a very positive story, there are a number of equally important statistics that need to be considered which counteract this growth. Firstly, our population is ageing. The number of Australians over the age of 65 is expected to increase by 75% over the next 20 years (from 3.3 million in 2012 to 5.8 million in 2032). Second, we are living longer and as a result Australian's are spending longer in retirement and need higher retirement savings to provide for their retirement.

Given the growth of the superannuation industry in Australia, it can be argued that the strength of these funds and their relatively similar investment choices, which are driven by the very nature of their investment needs, are one of the main factors driving many of Australia's financial markets. These distorting impacts need to be examined and better understood.

This is one of the key issues that this inquiry needs to examine, and to ensure that we have the right regulatory and supervisory structures in place to address these issues as they emerge over the next decade.

Recommendation:

CPA Australia believes that given the significant growth and development of the Australian superannuation and financial advice sectors over recent years that this inquiry make these two areas a major focus of this inquiry.

Given the importance of this change and the implications for Australia, and Australian financial services, we have included separate sections in this submission on both superannuation and financial products and advice.

The integrity of Australia's capital markets needs to be maintained

In May 2013, CPA Australia released the most comprehensive research ever undertaken on Australia's international competitiveness. This research drew on the insights of 6,000 Australian and international business leaders across 76 key competitiveness attributes, enabling a detailed examination to be made of the Australian economy as well as specific industry sectors, including financial services.

Our research shows that the efficiency and integrity of Australia's capital markets are a substantial competitive advantage for Australia.

We must ensure that the regulation, supervision and transparency of capital markets are consistent with Australia's aspiration to be a leading global and regional financial market. Continuing to improve on Australia's already high standards of reporting can lead to greater

efficiency in the allocation of capital and enhance Australia's reputation as an investment destination.

To enhance the effectiveness and efficiency of the capital market CPA Australia believes that the government needs to undertake a comprehensive cost-benefit analysis which examines making mandatory for listed public companies and listed registered schemes to lodge financial reports in inline eXtensible Business Reporting Language (iXBRL) format using Standard Business Reporting (SBR) with ASIC.

This analysis should also consider how best standard business reporting should be mandated, such as whether it would be in addition to existing reporting requirements, replace existing reporting requirements or leave it up to the reporter to determine how best to meet the requirement.

Recommendation:

CPA Australia recommends that the government undertake a comprehensive cost-benefit analysis which examines making mandatory for listed public companies and listed registered schemes to lodge financial reports with ASIC using Standard Business Reporting (SBR)

Financial literacy and education is vital for Australian consumers

A prerequisite of a well-functioning financial system are financially literate consumers and users of the system. As financial products and advice gets increasingly complex and Australia's pool of superannuation savings grows, increasingly it is incumbent on individuals to ensure that they are financially literate and understand the basics of financial services products.

As stated on the Government's Financial Literacy website 'Financial literacy is about understanding money and finances and being able to confidently apply that knowledge to make effective decisions'.

The National Financial Literacy Strategy was developed in 2011 to provide a national direction for this priority area with a revised strategy due to be released in early 2014.

In addition to the continuation and extension of publicly and freely available financial literacy tools such as MoneySmart, CPA Australia believes that financial literacy is an essential life skill, and as such the breadth of the Economics and Business curriculum area in schools should extend backwards into the early years and forward into the senior secondary years.

As a minimum, this level of financial education and awareness should be compulsory in years 9 and 10 as this is when many students start putting these skills to use. Further, the electives offered in the senior secondary years should facilitate high quality and consistent pathways into further learning and rewarding careers.

CPA Australia has recently made a submission to the Draft Shape of the Australian Curriculum: Economics and Business being conducted by the Australian Curriculum, Assessment and Reporting Authority (ACARA) which expands on these points. A copy of our submission is available here: www.cpaaustralia.com.au/~/media/Corporate/AllFiles/Document/about/joint-submission-on-the-business-curriculum.pdf

Recommendation:

CPA Australia recommends that this inquiry make financial literacy in Australia a key policy outcome from this inquiry, including strengthening financial literacy in schools as part of the Australian curriculum.

The global competitiveness of Australian financial services

As highlighted above, CPA Australia's landmark research, *Australia's competitiveness – from lucky country to competitive country,* was the most comprehensive work of its kind ever undertaken and the results served as a significant wake-up call for the nation. Worryingly, we found that despite our relative success in recent years against OECD countries, when compared against our closest neighbors in the region, such as Hong Kong, Singapore, Taiwan and Malaysia, many are already ranked higher than Australia on global competitiveness indices.

If we are to successfully compete with other nations in the Asian century, be it in financial services or other sectors, Australia needs to put in place strategies that will enable us to create stronger links with Asia, harness new and emerging opportunities, and leverage key markets in the Asia Pacific region and within a changing global economy.

The Competitiveness of Australia's Finance and Insurance Sectors

Our research also found that Australian firms in the finance and insurance sectors are no longer just competing with the firm down the road, but with global firms who may be half a world away and have the backing of some of the world's largest corporations. Some 68 per cent of survey respondents from the finance and insurance sectors stated that they were subject to international competition, despite 60 per cent identifying the domestic Australian market as the main market in which they compete. This further underscores the continued globalisation of financial services products and markets and the increased competition that this has meant for Australia and Australian firms.

The survey results also showed that currently, Australia's key competitors in the finance and insurance services sectors were firms from the United States and the United Kingdom.

When comparing Australia's performance against the 76 key competitiveness factors examined for this sector, Australia performed well compared to our key competitors in terms of our quality of life, the strength of the local banking system, social stability, macroeconomic stability and overall local economic conditions.

However, where Australia did not perform as well compared to our major competitors was in other taxes and charges (e.g. state taxes). Again, given the finding that this sector is globally open to competition it is important that we look at the various impediments to competition, such as local taxes and charges, if we are to maintain a competitive sector and continue to attract global players in the Australian market.

Other key factors which the survey found were driving the competitiveness of this sector included the quality of Australia's IT and internet infrastructure, our regulatory and legal framework, communication infrastructure and overall economic conditions.

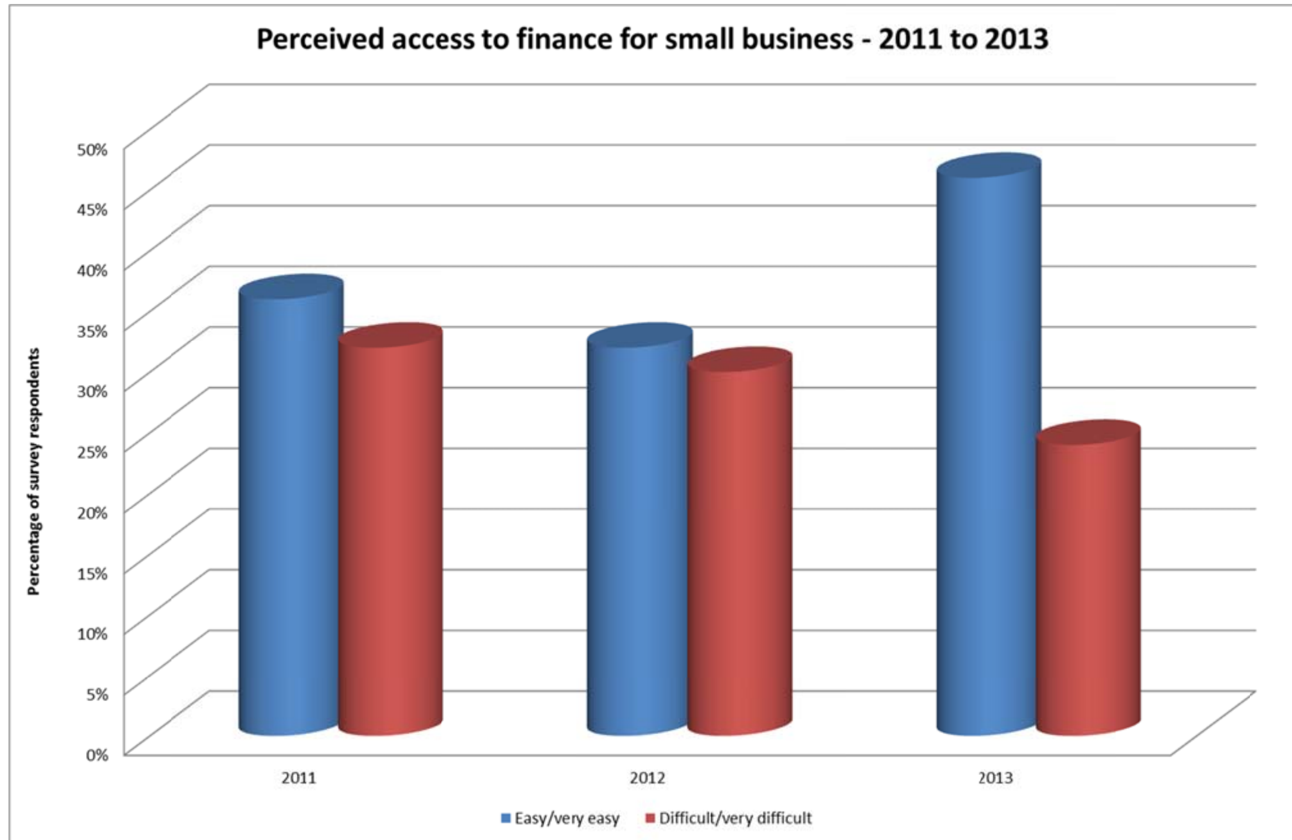
More broadly, the survey highlighted several key areas that Australia needs to address if we are to remain globally competitive in the future:

- the relatively high cost of doing business in Australia puts us at a disadvantage, especially our relatively high employment costs
- investment in education and training and a highly skilled workforce to increase its competitiveness levels and become a knowledge economy
- the need for improved infrastructure, including transportation, communication, utilities and technological infrastructure
- the opportunity to capitalise on Australia's close proximity to Asia, including becoming the Asia Pacific centre for the 24-hour a day business operations of international companies involved in high-value, knowledge-intensive activities
- the need for tax reform. CPA Australia believe that to create a more efficient system, various inefficient state taxes should be replaced with a higher rate or broader GST.

Small business access to finance

Perceptions on the availability of external finance to small business

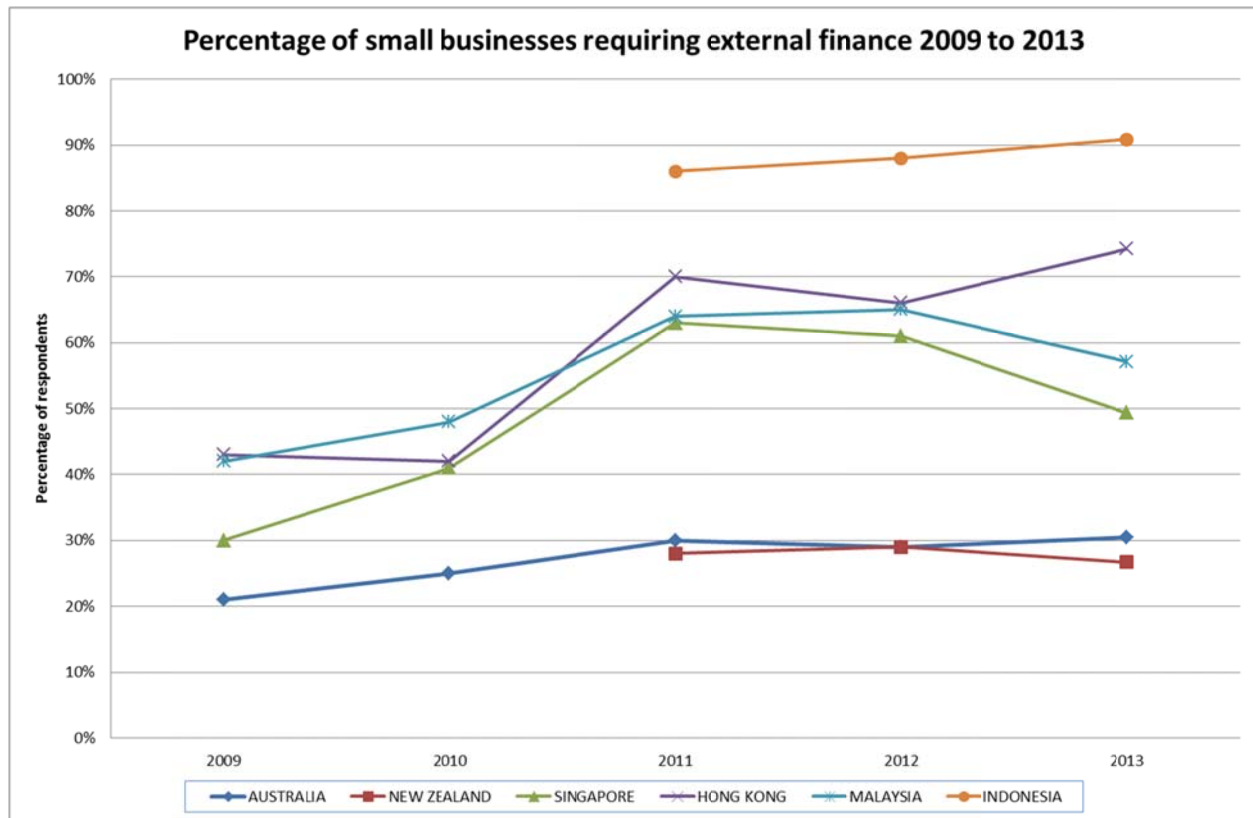
Since 2009, CPA Australia has conducted an annual survey on small business. Amongst other measures this survey examines small business access to finance. As the following graph shows, the survey shows that Australian small businesses perceive that access to finance became significantly easier in 2013 after a long period of tight credit conditions. CPA Australia members indicated that this trend is unlikely to be reversed in the near future.



Source: *The CPA Australia Asia-Pacific Small Business surveys 2011 to 2013*

Small businesses access to finance

As the following graph shows, in spite of many Australian small businesses reporting that access to finance became easier in 2013, this did not translate into an increase in small businesses applying for finance.



Source: The CPA Australia Asia-Pacific Small Business survey 2013

Reasons for accessing external finance

It has been speculated that the difficulty in accessing finance and meeting the requirements of lenders during the credit tightness following the GFC discouraged small business applying for finance. In 2011 and 2012, we asked small businesses that did not seek finance the reasons for this. As the below table shows, the lack of a need for a loan and the business having sufficient funds were by far the most important reasons for not accessing external finance.

The survey showed that except in a very small number of cases, complexities with the loan application process and the previous difficulty in obtaining finance was not a reason not to apply for finance.

Reasons for not applying for external finance in 2011 and 2012 - Australia

Reason	2011	2012
The business did not need additional funds	57%	64%
The business had sufficient funds under its existing arrangements	33%	44%
The risk of not being able to repay the loan	16%	4%
Interest rates were too high	11%	3%
Procedures to obtain funding from a financial institution were too complicated	7%	5%
The business no longer needed additional funds (for instance, cancelled investment plans)	10%	5%
The likelihood of unreasonable terms and conditions	8%	3%
It was considered unlikely a financial institution would provide the funding required	6%	2%
The potential to lose control of the business	4%	4%
A previous loan was rejected	2%	1%
Don't Know	N/A	1%

Source: The CPA Australia Asia-Pacific Small Business Survey 2012

Those small businesses that did apply for external finance over recent years stated various reasons for needed additional funds, including business survival, growth, increased costs and asset purchases.

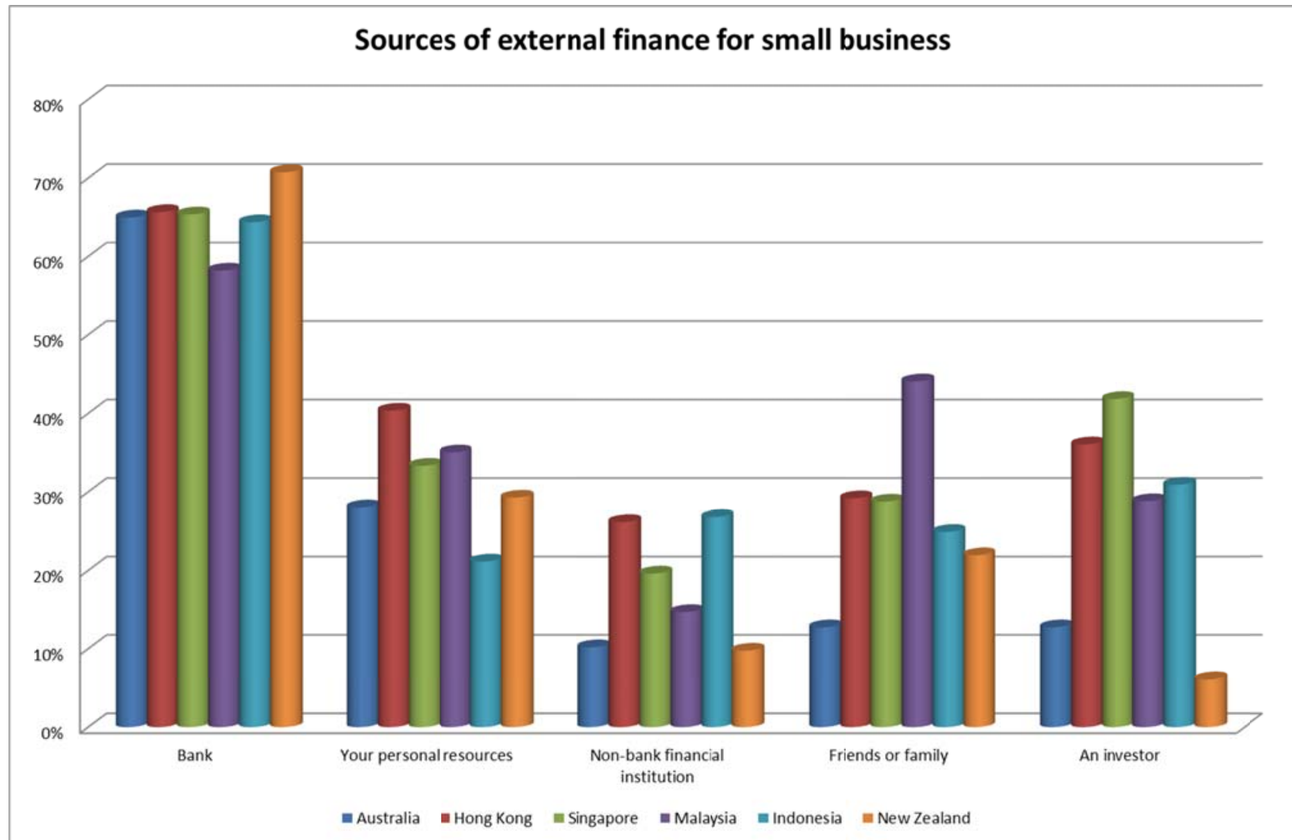
Reasons for applying for external finance 2009 to 2013 – Australia

Reason	2009	2010	2011	2012	2013
Business growth	29%	28%	29%	27%	31%
Business survival	42%	27%	41%	42%	23%
To purchase assets/capital assets	31%	19%	32%	26%	25%
To cover increasing expenses	29%	30%	41%	41%	24%
To fund stock purchases	26%	18%	22%	24%	20%
To cover late payments from debtors	17%	19%	22%	27%	13%
To service increasing costs on bank loans	5%	9%	11%	12%	4%
To cover tax payments	11%	8%	21%	23%	13%
To cover increasing sales	4%	4%	9%	7%	8%
To cover increasing rental expenses	N/A	N/A	N/A	N/A	5%
Other	2%	6%	2%	3%	5%
Don't know	2%	6%	0%	0%	1%

Source: The CPA Australia Asia-Pacific Small Business surveys 2009 to 2013

Sources of external finance

For Australian small business, bank finance is by far the most common source of external finance. In comparison to small businesses is Asia, Australian small businesses rely significantly less on non-banking financial institutions, family and friends, and investors as an alternative source of finance compared to similar businesses in Asia. This is despite the recent attention given to Peer-to-Peer financing for small business.



Source: The CPA Australia Asia-Pacific Small Business Survey 2013

Lessons for small business from the global financial crisis

A key lesson from the GFC for small businesses is the importance of a positive relationship with their lenders. Many members working for or advising the sector reported to CPA Australia that during the GFC their relationship with their lender broke down, primarily due to communication failures by their lenders.

While members have reported that banking relationships within the sector have improved, they remain concerned about the extent of the imbalance in the relationship between lenders and small business, particularly the ability of lenders to seemingly change terms and conditions without, what they consider, to be reasonable notice.

An important step to building greater certainty and balance in the relationship is improving the current Australian Bankers' Association (ABA) code of banking practice to better cover small business or introduce a separate small business code of banking practice. While the current code of banking practice does cover small business, a review of the small business codes of banking practice of the UK, Canada and Ireland shows that there is considerable scope to better cover small business in the Australian code.

CPA Australia therefore recommends that the ABA should either extend the current Code of Banking Practice to better cover small business or establish a separate code for small business.

We note that this recommendation has been made by four separate parliamentary inquiries into the banking sector, the most recent being recommendation 9.1 in the Senate Economics References Committee report titled 'The post-GFC banking sector' of November 2012.

Conclusion

Our research on small business access to finance from the commencement of the GFC demonstrates that lending conditions are easing for those small businesses seeking finance. This does not mean that there are not issues with small business access to finance however those issues appear to be with individual businesses rather than any systemic issue with the banking system. As such, it is far preferable that the banking industry work to address those issues, including improving its code of banking practice to better cover small business than further regulatory intervention.

Recommendation:

That the ABA compare its current code of banking practice against the small business codes of banking practice from Canada, Ireland and the UK and extend its current code of banking practice to better cover small business, or alternatively introduce a separate code of banking practice for small business

Tax reform in Australia

CPA Australia has welcomed the Government's commitment to developing a comprehensive White Paper on Australia's tax system over 2014/15. It is our view this inquiry, and its findings, ought to provide a critical input into that White Paper process.

Taxes and regulation can and do have a major effect on the way the financial services sector in Australia operates and introduces a number of impediments and barriers to the effective and efficient flow of capital in the Australian economy.

To this end CPA Australia would like to draw this inquiry's attention to the following issues for examination and consideration as part of this review, and that of the broader review of Australian taxes in the development of the White Paper on tax reform:

Taxes on savings

As the Australian population ages, the quality of our domestic saving decisions is going to become increasingly important.

As recommended by the Henry Tax review, the income from the savings of Australian residents, other than savings invested in owner-occupied housing and superannuation, remains a significant part of the personal income tax base. This review recommended that a 40 per cent discount be introduced for most interest income.

The review found that a more consistent tax treatment of household savings would encourage households to seek the best pre-tax return on their savings and to invest their savings in assets that best suit their circumstances and risk-preferences, and remove the current bias towards negatively geared investment in rental properties and shares.

Recommendation:

CPA Australia recommends that this review also examine the implications of Australia's current tax arrangements as they relate to household savings and the inefficiencies and distortions this creates in terms of capital flows and investment choices for Australia.

Interest withholding taxes

CPA Australia recommends that this inquiry also examine the current inefficiencies created by applying interest withholding tax on repatriated bank deposits and on interest income sources within or outside of Australia. This policy limits the incentive of Australian banks and other stakeholders to raise and repatriate funding from overseas, which limits access to liquidity and capital within the Australian market.

Recommendation:

CPA Australia recommends that this inquiry examine the impediments to capital and the potential distortions that interest withholding tax creates for Australia. If found to be inefficient and distortionary, this inquiry should recommend that this tax be removed.

Need for broad tax reform in Australia

More generally, CPA Australia's view is that Australia's current tax system remains a serious impediment to productivity growth and our international competitiveness. We continue to be concerned that without serious tax reform, federal and state governments will continue make changes based on the need for greater revenue, with little or no consideration given to the broader economic and social impacts.

This is the reason why we have urged the government to ensure that the White Paper on tax reform provides a foundation for substantive tax reforms which focus on improving Australia's international competitiveness and productivity, while also providing Australian governments with a stable and growing source of revenue and increased resilience to possible future shocks.

- ***Reducing the company tax rate***

The Abbott Government's commitment to reduce the company tax rate by 1.5 per cent to 28.5 per cent from 2015 has been welcomed by CPA Australia. There is clear evidence that reducing the tax burden on businesses increases their productivity, improves their competitiveness and lifts their ability to expand and create jobs. Despite it seeming counterintuitive, cutting the company tax rate and the resultant boost to business activity may result in more government revenue – not less.

However, to further improve the international competeviness of the business tax system, facilitate further capital inflows into Australia and to enhance productivity, CPA Australia recommends that the company tax rate be reduced, in stages, to 25 per cent.

- ***Reforming the GST and removing inefficient state taxes***

To help enhance Australia's overall productivity, and given the absence of any other currently viable option, CPA Australia supports raising the rate of GST and/or broadening the GST base under the circumstances that these changes facilitate the replacement of existing inefficient state taxes as well as the provision of cuts to personal income taxes. Australia's taxes on consumption, including the GST – as a percentage of government revenue – remain very low by OECD standards. A 2011 CPA Australia study by KPMG showed that by removing taxes that limit productivity, such as those on insurance, motor vehicles, conveyancing, and payroll tax – paid for by raising the GST – would result in an increase in the overall level of economic activity in Australia. This is an important and fundamental discussion that needs to be had at national and state levels with a view to developing a national plan for execution.

- ***Addressing base erosion***

To ensure that Australia has a sustainable and trusted tax system, it is critical to act on the erosion of the tax base. This process should involve measures which Australia can unilaterally take whilst actively working towards a multilateral response in international forums such as the OECD and G20. However, such a process must be targeted at egregious profit shifting activities and evasion rather than be used as a platform to raise revenue in the guise of attacking tax avoidance.

- ***Easing compliance burden***

To cut unnecessary business costs it is critical that the design and administration of Australia's tax system be reviewed to ease the unnecessary compliance burden imposed on taxpayers. CPA Australia believes that a range of measures should be implemented which lessen the regulatory compliance burden whilst maintaining a robust tax system that generates required revenues. For example, we support the introduction of safe harbour guidance for small and medium-sized enterprises under the transfer pricing regime which would strike a balance between protecting government revenue and reducing compliance costs.

- ***Cutting personal tax rates***

To provide a positive stimulus to the economy, encourage increased workforce participation, encourage mobile professionals to either stay in or relocate to Australia and increase productivity, it should be a key aspirational goal that Australia's top individual income tax rate be progressively reduced to 40 per cent.

Most Australian businesses are both small and unincorporated and are therefore taxed at individual marginal tax rates and not the corporate tax rate. A cut in personal income tax rates is not only a benefit for salary earners, it is also a cut in tax for Australian small business.

CPA Australia looks forward to making a substantial contribution to the development of the government's White Paper on Tax Reform.

Recommendation:

CPA Australia is a strong supporter of a complete review and reform of Australia's tax system to enable Australia to be globally competitive in the years and decades to come.

Financial Advice in Australia

The FSR and FoFA reforms

Given the exponential growth in savings in Australia since the introduction of the Superannuation Guarantee in 1992, the regulation and innovation of financial products and the provision of advice has come to the forefront of the regulatory debate for financial services in Australia.

Prior to the Wallis inquiry, Australia's financial system regulation was piecemeal and varied and was designed according to the particular industry and the product being provided. To address this, the Wallis Inquiry recommended that regulation of similar financial products should be more consistent, and promote competition by improving comparability.

The Financial Services Reform Act (FSR) which commenced on 11 March 2002, was the culmination of an extensive reform program which examined existing regulatory requirements that applied to the financial services industry. It implemented a single licensing regime for financial sales, advice and dealings in relation to financial products, consistent and comparable financial product disclosure and a single authorisation procedure for financial exchanges and clearing and settlement facilities.

While the FSR implemented more uniform regulation, it was also intended to reduce administrative and compliance costs by removing unnecessary distinctions between products as well as providing consumers with a consistent framework for consumer protection.

Time has shown that this system has delivered on some of these intended benefits and for the most part has been successful in ensuring adequate consumer protection for Australians.

However, the GFC has exposed a number of flawed advice models, which were primarily driven by third party payment benefits, in which Australian consumers lost millions of dollars of their life savings.

These losses were the catalyst for further reform and resulted in the Future of Financial Advice (FoFA) reforms. The underlying objectives of these reforms were to increase consumer confidence in the market by removing conflicts of interest from the advice process.

These reforms were appropriate and illustrated that the Australian regulatory system was reactive to changes in the market.

CPA Australia supports the original FoFA reforms and the drivers of these changes. However CPA Australia has also stated that the fundamental change that is necessary to deliver consumer confidence in the financial advice market is the clear separation between financial products and financial advice which was missing in the initial legislation.

The separation of financial products and advice is needed

CPA Australia believes that one of the major flaws in the existing regulatory system is that there is no separation between financial products and financial advice.

Under the FSR, a person is considered to provide a financial service if they provide financial product advice. Financial product advice means a recommendation or a statement of opinion or a report of either of these things that is intended to influence a person in making a decision about a particular financial product or could reasonably be regarded as being intended to have such an influence.

This central definition has inhibited innovation in the sector due to the high level and cost of the existing compliance obligations dictating how this advice must be provided.

Every time a financial adviser provides advice that relates to a financial product, they must comply with a number of legislated compliance disclosure requirements. The most onerous of which has become the provision of a statement of advice (SOA).

As summarised in ASIC's Regulatory Guide 175: *Licensing: Financial product advisers—Conduct and disclosure,* the intended objective of the SOA is to be a document that helps a retail client understand, and decide whether to rely on, personal advice.

What it has evolved into over more than a decade since its implementation is a compliance document that a financial adviser uses as part of their audit trail for protection from potential litigation.

This culture has been driven by multiple influences, including the mandatory membership requirement of an ASIC approved external dispute resolution (EDR) scheme, where decisions are binding on the member. Consumers must have access to a free complaints resolution processes however many would question the unintended consequence that this regulation is having on the risk profile of the industry. Further on the issue of risk mitigation within this market, professional indemnity insurers are now also dictating how a financial adviser may operate to manage and reduce the insurer's exposure to risk. For example, some indemnity insurers require that no client can have more than 10 per cent invested in unlisted assets.

The result is a lengthy document that provides little or no benefit to the consumer and fails to ensure they are in a position on whether to rely on the advice they are being provided.

This is yet another compelling reason why the current framework needs to be revisited.

The real benefit of financial advice is the advice itself and we need to ensure that we have a regulatory system that allows for this to happen, otherwise the advice provided is constrained and will not deliver the best result for the advisors clients.

Separating the 'advice' and the 'product' will result in advisers being able to provide non-product strategic advice in a more efficient and effective manner to clients, delivering confidence and transparency to this sector.

Recommendation:

CPA Australia recommends that to remove a major inconsistency in Australia's regulatory system that the inquiry examine the separation of the regulation of financial products and the regulation of financial advice.

Aligned vs non-aligned advice

CPA Australia also supports the separation and disclosure of aligned and non-aligned advice providers. It is well known that within the Australian market that around 80 per cent of the industry is aligned and or owned by a large bank or financial institution. This association has also led to the general perception by consumers that financial planning advisors are 'product floggers' rather than trusted advisers and their independence is often in question.

By separating the advice and the product as well as creating a distinction between aligned and non-aligned advice, one of the key objectives of a well-functioning market – transparency – would be created. This would then provide a strong foundation on which to build confidence and engagement between the advisory industry and consumers.

By establishing this model it is expected that this would lead to a fee for service advice model which is more aligned with that of a profession rather than an industry, eliminating the majority of the conflicts the industry currently grapples with when providing advice.

Given that the number of people seeking financial planning advice has not increased beyond the estimated 20 per cent or so since the implementation of FSR (ASIC Report 224) real change is needed to drive consumer engagement in this sector.

Recommendation:

CPA Australia recommends that the inquiry examine the separation and disclosure of aligned and non-aligned advice providers within the Australian market with a view to increasing transparency and confidence in the Australian market for financial advice.

Efficient and smart regulation is needed, not duplication

While FSR was successful in bringing together multiple regimes, what has evolved since then are areas of regulation that overlap the financial services industry.

Traditionally a holistic financial adviser would look at a client's entire financial position, needs and goals. This would include debts, investments, structures and tax.

Since the introduction of the FSR there has been the relatively new regulation of both consumer credit (through the National Consumer Credit Protection Act, the NCCPA) and the proposed regulation of tax advice by financial planners (through the Tax Agents Services Act).

These measures either have or will result in a financial planner being required to be licensed under the Australian Financial Services Licence (AFSL) regime, licensed under an Australian Credit Licence (ACL) and being a registered tax (financial) adviser - all in order to continue to providing the same advice.

It is important that financial planners do not continue to give tax advice, which is legal advice, without being registered as tax agents. However in respect of FSR and the NCCPA we note that many of the obligations for a separate financial product and credit product regime are identical. The premise for two separate regimes was to ensure consumers were not confused as one invests money and the other borrows money. Given the increasing cost of compliance and the regulatory burden this has on firms brings into question the benefits of imposing this additional licensing regime on advisers, rather than simply incorporating it into the AFS licensing regime.

Research by ASIC (Report 224[1]) estimated that a financial plan cannot be developed for less than $2500 and complex advice would cost considerably more than this whereas consumers believe, on average, that initial advice should cost around $301 with ongoing advice priced at around $298 per annum.

There is obviously a significant disconnect between the actual and perceived cost of advice in Australia.

To address this gap, it is important that Australia have smarter, rather than more legislation to provide the necessary protections to consumers in the provision of financial advice.

The reality however is that we are currently regulating to the lowest common denominator, the impact of which is cost-prohibitive advice.

Recommendation:

CPA Australia recommends that the inquiry look to remove duplication and overlap in the current regulatory system for financial advice in Australia to reduce regulatory burden and cost on Australian advisers and by extension, consumers.

[1] Access to Financial Advice in Australia, ASIC 2010.

The Australian Superannuation Sector

As outlined earlier in this submission, as at 31 December 2013, Australia's superannuation system held $1.8 trillion in assets making it the fourth largest retirement system in the world. A recent Deloitte study projects superannuation assets will grow to around $7.6 trillion by 2033, or in real terms, from less than 100 per cent to approximately 180 per cent of Australia's GDP over the next 20 years. This sector needs to be one of the focuses of this inquiry.

Investments

Given the exceptional growth of Australian superannuation funds over recent years, industry and retail funds currently have significant holdings of Australian equities which may be negatively influencing Australia's relatively small share market.

Despite this, CPA Australia believes that investments should not be externally restricted or mandated in any way. The primary objective of superannuation is long term retirement savings, that is, growing and maximising members' retirement savings. Restricting investments could result in significant distortions in Australian markets by artificially increasing the demand for certain asset classes and taking investments away from alternative, well performing asset classes.

An example of where this occurred was during the 'bond crisis' of the late 1970s where the '30/20 rule' was introduced to encourage sufficient cash holdings within funds (including SMSFs) and to promote government bonds. This policy worked against the best interest of fund members and was eventually removed.

Self-managed superannuation funds

Self-managed superannuation funds (SMSFs) now comprise the largest and fastest growing segment of Australia's superannuation system, holding almost a third of all assets with a value of $543.4 billion at 31 December 2013.

SMSFs are a legitimate and valuable retirement savings vehicle for many. SMSFs allow people to be highly engaged with their superannuation fund and management and provide SMSF holders with greater control, flexibility, and ownership of their superannuation decisions.

In terms of innovation, SMSFs often lead the way. For example, the introduction of allocated pensions and member level tax management began with SMSFs.

The vast majority of SMSF trustees are genuinely saving for their retirement and trying their best to comply with often complex rules and regulations. However, perceptions exist in the Australian market that:

- SMSFs are being recommended inappropriately
- SMSFs are not as closely regulated as large funds and are being used inappropriately for purposes other than saving for retirement

- many SMSF trustees do not have the necessary knowledge or experience to run their funds effectively and comply with the law
- SMSFs are fuelling the next property investment bubble.

However, industry research and ATO statistics do not support these perceptions.

Recommendation:

CPA Australia believes there is no evidence to suggest significant change is necessary regarding the structure, operation and/or regulation of SMSFs.

SMSF borrowings

Following the relaxation of borrowing restrictions for all superannuation funds in 2007 there has been significant commentary, confusion and scaremongering about the growth in SMSFs borrowing to invest in property.

CPA Australia believes that borrowing, or gearing, can form an important part of a long term wealth accumulation strategy and that the current exceptions to the borrowing provisions are appropriate.

It is however important that trustees only enter into these arrangements in accordance with, and as part of, a properly formulated and prudent investment strategy. It is the trustee's responsibility to consider the appropriateness of these arrangements when developing their investment strategy, taking into account risk, return, liquidity needs, cash flow and the needs of members.

CPA Australia's concern regarding SMSF borrowing relates to the appropriateness of the advice received and potential misinformation that is currently being provided in the market by unlicensed advisers, such as real estate agents, mortgage brokers and property developers.

It was a recommendation by the Cooper Review that the borrowing provisions and consumer protection measures would be reviewed in two years' time (that is, in 2012) to 'ensure that borrowing has not become, and does not look like becoming, a significant focus of superannuation funds'.

Recommendation:

CPA Australia strongly supports a review that focuses on the appropriate use of borrowing, on risk minimisation, the licensing of advice providers and on the level of consumer protection, especially for SMSFs

Product development / income streams

As expanded on later in this submission, there are very few products (if any) that are currently available to reduce longevity risk. This is partly due to legislative restrictions and partly due to the lack of sufficient underlying long-term investments, such as government bonds, to underpin these products.

Many of the traditional life-time product providers have left this market due to the difficulty in pricing these products and the effects of holding both investment and longevity risk on these products.

Recommendation:

CPA Australia believes that incentives are needed to encourage a long-term Australian bond market which could be supplemented by the issuance of long-dated government securities. This would encourage greater private sector participation and therefore reduce the future burden on Government as the longevity insurer of last resort.

We also support and encourage the Government to make a priority its review of the regulatory impediments to the availability of relevant and appropriate retirement income stream products.

Insurance

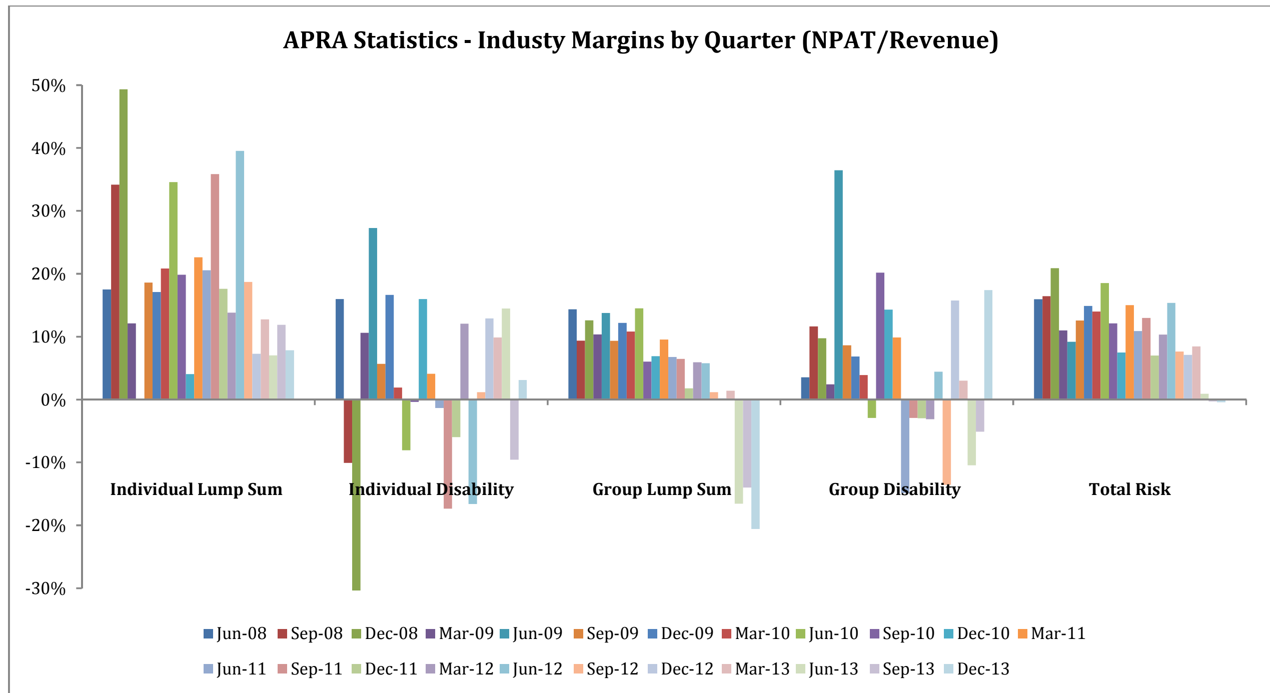
CPA Australia is concerned about the sustainability of the life insurance sector, and the impact this may have on the Australian superannuation system as insurers redeploy capital away from unsustainable lines, seek to recover losses through significant premium rate increases, or exit the industry altogether.

According to recent APRA statistics, industry profitability for Group Lump Sum insurance has been declining and has been negative for the past three quarters. In Group Disability, the situation appears worse with high volatility in profitability, as shown in the following chart.

When considered together, we understand that industry profitability is in decline as:

- Product definitions (for Disability) have become less stringent over time, making it easier to qualify for life insurance within superannuation with little or no underwriting
- Members have become more aware of their insurance coverage as benefits have increased
- Lawyers have become more involved as access to workers' compensation benefits has been tightened up

- Higher unemployment is making it harder for disabled people to return to work in some sectors of the economy.



Source: APRA Quarterly Statistics December 2013

CPA Australia welcomes the Federal Government's planned review of the insurance sector in light of the major reduction in capacity affecting the group market and the potential impact this will have on Group premium rates and the superannuation savings of all Australians.

Recommendation:

CPA Australia believes Australians should have access to affordable insurance protection, and urges the inquiry to consider how insurance should be structured under superannuation to ensure long term sustainability and equity in the system.

Overseas portability and flexibility

With the continued globalisation of markets and the international mobility of labour, a number of barriers currently exist that prevent Australian workers from transferring superannuation into or out of Australia or maintaining superannuation when they are temporarily out of the country.

Exclude overseas benefits from contribution limits

CPA Australia believes benefits transferred from overseas superannuation funds should be exempt from current superannuation contribution limits.

By applying the current limits to those temporarily working overseas make it difficult, if not impossible, for individuals to transfer their retirement savings into Australia. For this reason, CPA Australia believes that the transfer amount should be exempted from the limit on non-concessional contributions to Australian superannuation funds and that the amount elected to be treated as taxable contributions (i.e. the earnings) should be exempted from the concessional contribution limit.

Despite the risk that this type of exemption may provide the opportunity for individuals to funnel contributions through overseas superannuation funds, we believe that the risk of this is low due to the difficulties involved with residency, termination of employment, taxation and payment rules with this type of arrangement.

This issue was recognised by The Senate Standing Committee on Economics in its inquiry into the simplified superannuation legislation[2]. The Committee concluded that the government consult with the superannuation industry to develop anti-avoidance measures to allow bona fide overseas transfers in excess of the non-concessional contribution cap.

Recommendation:

CPA Australia supports the introduction of measures that enable transfers from overseas superannuation funds to Australia which are not subjected to current contribution cap limits.

Definition of Australian superannuation fund

Subsection 295-95(4) of the *Income Tax Assessment Act 1997* requires the 'central management and control of a superannuation fund be ordinarily in Australia' and if it is temporarily overseas that this period is no greater than two years. Whilst this limitation is applicable to all funds, we believe that it would most typically arise in the context of SMSFs, especially single member funds.

This legislation fails to recognise that increasingly, Australians who are members of self-managed superannuation funds are working overseas and these moves, although considered temporary, are generally for an undefined period of time or may be extended which would make their absence from Australia longer than two years. In this circumstance, although the individual retains the intention to return to Australia and retains strong linkages to Australia, pursuant to subsection 295-95(4) the central management and control of the fund would no longer reside in Australia.

Under this scenario, these Australians are therefore prevented from continuing their self-managed superannuation fund while they are absent from Australia and their fund ceases to be a complying fund and tax is imposed on the amount calculated under section 295-325.

[2] Report on *Tax Laws Amendment (Simplified Superannuation) Bill 2006 [Provisions] and related bills [provisions]*, Senate Standing Committee on Economics, pp 24-25.

To address this issue CPA Australia recommends that subsection 295-95(4) be amended to broaden the tests that can be applied to determine if ‘central management and control of a superannuation fund be ordinarily in Australia’. Such additional tests should largely be focused, like the tests for individual residency for income tax purposes, on the intention of the individual member of the SMSF. This would provide greater flexibility in determining if ‘central management and control’ of a superannuation fund remains in Australia where an individual member of a SMSF works overseas for a period of greater than two years.

This amendment would increase the ability of these funds to retain capital and invest in Australia.

Recommendation:

CPA Australia recommends amending subsection 294-95(4) of the ITAA 1997 to provide greater flexibility in determining if ‘central management and control of a superannuation fund be ordinarily in Australia’ for an individual Australian resident who is a member of a SMSF who chooses to work overseas for a limited, but undefined, period of time.

Australia's retirement savings policy

Overview

CPA Australia believes the current structure of Australia's retirement savings system – that is, the three pillars: the aged pension, compulsory superannuation and voluntary superannuation savings – is appropriate to meet our retirement savings goals.

However, the challenge is to ensure that the right mix is maintained that provides adequate retirement savings for individuals but also maintains a system that is simple, efficient and equitable.

CPA Australia believe that Australia's retirement savings system could and should be improved, with particular focus on adequacy of savings, reducing complexity and improving equity.

We believe that Australia's savings policy should:

- Establish a long-term vision for Australia's retirement savings policy which clearly articulates its purpose and goals
- Alleviate poverty, provide mechanisms to assist and encourage self-funded retirement savings and insure against risk.
- The savings system must be simple, sufficient and sustainable.
- Maintain the 'three pillars' structure but increase the simplicity of the system to increase the efficiency of the system.
- As the Superannuation Guarantee (SG) system matures, the first pillar - the age pension – needs to shift back from supplementing the compulsory system to being a genuine safety net.
- Target government assistance at low and middle income earners to encourage retirement savings.
- Assistance needs to be provided to individuals on the fringe of the compulsory system by improving access to, and the efficiency of, SG contributions, extending access to the co-contribution and providing more flexible contribution limits.
- Extend compulsory superannuation to the self-employed and the inefficiencies such as the '10 per cent rule' for claiming a tax deduction on contributions be removed.
- Retirement savings goals may best be achieved at an individual level through the provision of end benefit projections for individuals.

- The tax burden on superannuation should shift from the contributions phase to the benefits phase.

- The preservation age and threshold for tax free superannuation benefits should be aligned with the age pension age.

- Appropriate incentives need to be provided to encourage a retirement income stream culture.

The retirement income system

CPA Australia believes that the primary objectives of Australia's retirement savings system are threefold:

1. To provide assistance and incentives for individuals to save sufficiently and effectively in order to maintain a reasonable standard of living throughout their whole life cycle, i.e. to provide mechanisms to smooth income and hence consumption through both their working life and retirement.

2. Where individuals have not had the means to save sufficiently, the system should provide adequate support to alleviate poverty.

3. To provide insurance to protect retirees from certain risks, such as mortality, morbidity, longevity, investment, inflation and system failure.

An ideal retirement savings system should also display three primary characteristics. It should be:

- Simple – the system should be free from complexity in design, implementation and operation. The average person has to be able to understand it if they are to accept it and engage with it.

- Sufficient – to provide an adequate level of retirement savings to maintain a reasonable standard of living in retirement.

- Sustainable – not only in the sense of being able to maintain government support and expenditure for future generations but to also be robust to withstand external shocks – such as the GFC – and maintain equity to ensure continued support and engagement of the system thus minimising the risk of future system change.

Ideally, the most equitable retirement savings system would tax income in the hand of the individual when it is actually received.

The current tax concessions are heavily skewed towards high income earners, with low income earners getting little, if any benefit. The removal of end benefits tax from age 60 may have been appropriate in the short term as current and imminent retirees have not had access to a mature SG system. However, as the system matures we believe it would be appropriate to rethink this position in the long term and consider shifting some of the tax burden from the contributions phase to the benefits phase, albeit with a long transition phase.

A long lead time for change is also needed to minimise any disadvantage for the current generation who haven't had the SG all their working life, have only had low age-based deduction limits, haven't had the government co-contributions in their younger working years, and have been subject to the contribution surcharge. Too many changes too soon may see this age group becoming the disadvantaged group as they were either too young or too old to gain any advantage from recent positive reform but have experienced many of the negative measures.

Superannuation is a long-term savings vehicle that needs a long-term vision and direction. However, successive governments have viewed Australia's superannuation savings as a 'honey pot' to dip in to when required. Constant rule changes and revenue grabs have undermined public confidence in the system and threaten Australia's long-term savings

While the Government's pledge to not make any unexpected detrimental changes to superannuation is a commendable start, a long-term vision for Australia's retirement savings needs to be articulated to provide insight into the purpose and goals, eg. poverty alleviation or maintenance of living standards, and how these goals can be achieved.

Finally, with regard to the first pillar, the aged pension, this has always represented as a 'safety net' for those individuals who have not had the means to save sufficiently for themselves. However, there has been a very real shift, and acceptance, so that the age pension is supplementing the compulsory system (or vice versa) to the point where some 80 per cent of retirees are receiving at least part of the age pension. This is understandable at the moment as current retirees have not had the benefit of a mature SG system. However, as the SG system matures this dependency needs to be wound back so that by the time the system has fully matured, around 2035, the age pension is only being provided as a genuine safety net for those members of society in genuine need.

A broad and adequate superannuation system

Modelling conducted by the National Centre for Social and Economic Modelling (NATSEM)[3] for CPA Australia shows that increasing the compulsory superannuation guarantee (from 9 per cent to 12 per cent) will only provide an adequate standard of living in retirement for an individual on average earnings under ideal conditions and assumes that they have had compulsory superannuation contributions for the whole of their working life.

[3] NATSEM, CPA Australia, *Superannuation: the right balance?*, 2012, unpublished

Given this ideal scenario is not common, CPA Australia believes that assistance should be given to those with broken work patterns to maximise their superannuation savings and reduce their reliance on the aged pension. This can achieved through a combination of measures, including:

1. Introduction of a low-income superannuation contribution scheme
2. Extending the co-contribution scheme and also include individuals outside of the paid workforce
3. Remove the minimum SG threshold of $450 per month and replace it with a one month only threshold of $450
4. Provision for the ability to catch up on missed contributions while out of the workforce or earning a low income by allowing for a rolling concessional contribution cap, similar to the three year provision for non-concessional contributions, or a lifetime contribution cap.
5. Extension of the compulsory superannuation scheme to the self-employed and removal of the '10 per cent rule' for claiming a tax deduction on contributions.

1. Introduction of a low income superannuation scheme

Low income earners who pay no tax on their income currently receive no tax benefit for making concessional contributions to superannuation as contributions and earnings are also taxed at a maximum of 15 per cent.

In this scenario, low income earners may actually be better off receiving the extra income in their hand than in compulsory superannuation contributions. While low income earners do qualify for the government co-contribution, they may not have the disposable income available to channel towards superannuation to obtain it.

The 15 per cent tax on the 9.25 per cent SG contributions means the effective contribution to an individual's superannuation account is only 7.86 per cent.

To provide a concession to low income earners for locking their income away in superannuation that is commensurate with that enjoyed by higher income earners we believe that the contributions tax on SG contributions should be rebated for low income earners.

Recommendation:

CPA Australia recommends the introduction of a low income superannuation contribution scheme as part of a revised broad and equitable superannuation system.

2. Extend the co-contribution scheme

Given the incentive provided by a co-contribution scheme, especially for low and middle income earners, to increase their investments in superannuation, CPA Australia recommends the extension of the co-contribution scheme on a dollar for dollar matching basis up to a maximum of $1,000 for low and middle income earners.

Further, any system of co-contribution should also recognise those outside of the paid workforce, such as carers, parents raising a family, students or the unemployed. To ensure that this group are not disadvantaged in retirement, CPA Australia recommends that the co-contribution scheme also be extended to people outside the workforce.

Recommendation:

CPA Australia recommends extending the co-contribution scheme and include individuals outside of the paid workforce.

3. Abolishing the minimum superannuation guarantee threshold

The superannuation guarantee earnings threshold of $450 per month was introduced when Superannuation Guarantee commenced at a level of 3 per cent of salary. Since this system was established Australia's labour force has changes with an increasing proportion of casual and part-time workers.

As a result of the change to work patterns, more people are now at risk of being excluded from the SG system and may therefore not have access to adequate retirement savings in the future. For example, an individual working two or three casual jobs, each earning just under the $450 threshold each month, could be foregoing SG contributions of between $1000 to $1500 each year.

To boost retirement savings, particularly for people with broken or casual work patterns, CPA Australia recommends abolishing the SG threshold. However, we do recognise the administrative burden that may be experienced by employers when meeting their SG and choice of fund obligations for casual or itinerant employees. As a result we would support the exclusion of this scheme for one-off or short-term employment situations. One solution would be for employers to only be permitted to apply the $450 threshold once for a single month for an individual employee. That is, it would generally only be utilised in their first month of employment after which if their employment continues, SG should be paid.

Recommendation:

CPA Australia recommends that the Superannuation Guarantee earnings threshold of $450 per month to be replaced with a one month only threshold of $450.

Each of the three of the recommendations above – removing contributions tax on SG for low income earners, extending the co-contribution scheme to individuals outside of the paid workforce, and abolishing the minimum SG threshold – would provide a significant and immediate improvement to the retirement savings of individuals who spend extended periods out of the fulltime paid workforce, particularly parents raising children and fulltime carers.

4. Flexible contribution caps

CPA Australia recognises the need to properly target, but limit, the taxation concessions available within the superannuation system. While it is appropriate to limit the amount of money that can be contributed by or for an individual to the superannuation system on a concessional basis, we believe the current contribution caps, particularly the concessional contribution caps, are both confusing and inflexible and prevent many ordinary Australians from saving adequately for their retirement.

While the halving of the concessional contribution cap from 1 July 2009 may have reduced some of the disproportionate tax concessions enjoyed by high income earners, it also reduced the ability of average Australians to adequately save for their own retirement.

Many people, particularly the self-employed, have 'lumpy' income and only contribute to their superannuation when times are good. Others, in their late forties or early fifties, having paid off their mortgages and children's' educations, look to put the extra funds into their super to make up for previously inadequate contributions. The reduction in the contribution limits also came at a time when many Australians were only just starting to see the value of their superannuation recover from the impact of the GFC and people, particularly those close to retirement, were looking to get more money into their super to make up for the loss before they retire.

Our members have provided numerous examples of their clients who have been unreasonably disadvantaged by the contribution caps or unfairly penalised for inadvertently breaching the caps. These examples include:

1. A 55 year old teacher who has paid off the mortgage and was contributing extra to provide adequate retirement savings for himself and his wife who does not work. As a result of the halving of the cap he has had to delay his retirement date and they will retire with less than planned.

2. A widow in her late 60's with no savings outside of her superannuation wishing to boost her retirement savings at the last moment while she can still contribute but has been prevented from doing so by the lower cap.

3. A self-employed father of four in his late 40s on a high middle-income working long hours to try and get more money into superannuation and slow down in his fifties and spend more time with his family will now have to work longer to try and reach his retirement goals.

4. A 57 year old teacher diagnosed with cancer who will be forced to retire early due to her illness and wants to get as much into her superannuation as she can but has been prevented by the lower cap and was assessed for excess contributions tax after mistakenly breaching the cap last year. She fears she will struggle financially when she retires.

5. Senior university lecturers earning more than $147,000, whose employers are contractually obligated to contribute 17 per cent of their salary to their superannuation, are unable to avoid excess contributions tax on their concessional contributions.

CPA Australia believes the government should considers the introduction of a 'lifetime' concessional contribution cap whereby any 'unused' contribution limit, i.e. the amount above the actual contribution made, in one year could be accumulated and added to the limit in later years. At the very least a rolling cap, similar to the 'bring forward' rule for non-concessional contributions cap should be considered.

Recommendation:

CPA Australia supports the establishment of a 'lifetime' or rolling concessional contribution limit

5. The self-employed

It is sometimes argued that many self-employed people save for their retirement through their business and that this can generate a valuable retirement benefit. However, statistics on business exits indicate this is a high risk strategy as the individual's retirement income is linked to the operation and success of their business.

While a small business may be successful for the purpose of providing income while self-employed, there is no guarantee there will be a buyer for that business at the time that the individual wants to retire.

The Productivity Commission in its report '*Business Failure and Change in Australia*' found that only 50 per cent of small businesses continue to exist after 10 years and the Australian Bureau of Statistics also found that only 43 per cent of business operators (as opposed to businesses per se) had been operating their business for ten years and of that figure 49 per cent had been operating their business for 20 years. While a percentage of these businesses may be profitable there may be barriers to an orderly transfer. This implies there is a significant risk of the self-employed having all their savings in the one basket. Therefore, it is imperative that independent superannuation savings are provided for and encouraged.

The long-term benefits of extending compulsory superannuation to also cover the self-employed to encourage retirement savings outweigh the negative impacts, such as on cash flow. As such, CPA Australia recommends that those who are self-employed be required to contribute a percentage of their annual pre-tax income to superannuation that is the equivalent of the superannuation guarantee.

Incentives are also needed to encourage the self-employed to contribute above the compulsory amount and to ensure they have equal access to the tax concessions provided to employees. Employment arrangements have become more flexible with many people employed under casual or contracting arrangements. Those who consider themselves largely self-employed have found they may have lost their eligibility to claim a deduction for superannuation contributions after taking on relatively small consulting or contracting roles.

There is often a double whammy effect in that these contracting roles will only pay SG contributions and there is no provision for the contractor to make voluntary contributions. The result is individuals may end up with minimal superannuation coverage since they do not have any more than SG coverage from their employment, and they are not able to claim a deduction for their own contributions. These individuals are at a distinct disadvantage compared to those who are full-time employees or exclusively self-employed.

Recommendation:
CPA Australia recommends extending compulsory superannuation to the self-employed.

6. The deductibility of superannuation contributions

Abolishing the 10 per cent rule would allow employees to claim a deduction for their personal superannuation contributions.

With full deductibility being given to personal contributions, there is essentially no difference between the treatment of employer, salary sacrifice and personal deductible (i.e. self-employed) contributions and therefore no rationale as to why such deductibility is not permitted. Allowing deductibility for personal contributions would also benefit those employees whose employers limit or do not provide for salary sacrifice contributions.

The $25,000 annual limit on concessional contributions would control the concessions available and there would be no benefit in exceeding the limit as excessive contributions would be taxed at the top marginal tax rate.

Abolishing the 10 per cent rule would create a level playing field whereby all superannuants would have the same access to concessional contributions and the same flexibility to decide whether their voluntary contributions should be made from before or after tax income.

The limits on concessional and non-concessional contributions would ensure everyone receives the same tax concessions. Such a move would be another important step in ensuring equity and simplifying the superannuation system.

Recommendation:
CPA Australia recommends abolishing the '10 per cent rule' for the deductibility of superannuation contributions to provide greater incentive and flexibility to people who are required to make their own superannuation provisions.

Access age for superannuation and the age pension

To ensure retirement savings are maximised for use in retirement, CPA Australia supports a gradual increase in the preservation age for compulsory and government funded contributions (co-contributions) so they align with the age pension age. CPA Australia also supports earlier access for voluntary contributions, provided it does not add any unnecessary complexity.

Given that individuals in many vocations, particular the trades and blue collar industries, may not be physically able to work to age pension age we suggest the conditions of release be modified to align with this need, possibly aligning with the current eligibility for disability support.

We also support the continuation of the transition to retirement provisions, however they should be tightened to ensure they are only being utilised by individuals actually transitioning from full-time employment to retirement.

To encourage greater workforce participation, we also suggest the threshold for tax free benefits be aligned with the increase in the preservation age so that ultimately it would be the same age.

Given the current age pension age of 65 was set when life expectancy was 55, it is difficult to argue against a gradual increase in the age pension age when the average life expectancy is now over 80. However, consideration should be given to incentives to encourage people to work past age pension age and/or defer commencement of the age pension. While the pension bonus scheme provides some encouragement, it can be difficult to access, has had low take up and does not encourage self-funded retirees. One option may be a rebate, similar to the Senior Tax Offset, that can only be applied against 'gainfully employed income' to target individuals still in employment and prevent access by 'wealthy' retirees who may use it to offset investment income.

Managing investment and longevity risk

With the move to a defined contribution system and choice of fund, the responsibility for investment and longevity risk has shifted to the individual. In turn, many look to the financial markets to minimise these risks. While the financial markets provide products and diversification to minimise investment risk, there are very few products (if any) available to reduce longevity risk. This is partly due to legislative restrictions and partly due to the lack of sufficient underlying long-term investments, such as government bonds to underpin these products. Also, many of the traditional life-time product providers have moved away from providing life-time products as they are adverse to carrying investment and longevity risk on these products.

The other factor that has increased longevity risk has been the move away from encouraging lifetime income streams in retirement. Prior to the simpler/better superannuation changes there were tax concessions to encourage income streams and limits on the tax concessions for lump sums through the RBL system. Currently there is no incentive or compulsion to take an income stream over a lump sum.

The Government has pledged to review the regulatory impediments to the availability of relevant and appropriate retirement income stream products.

CPA Australia believes income streams should be encouraged over taking superannuation lump sums. Our research report in October 2012, Household savings and retirement: *Where has all my super gone?* showed that many Australians are using superannuation to extinguish household debt rather than fund retirement.

We encourage the Government to proceed with their review of retirement income streams to ensure there are viable products and investments available to support income in retirement and people are encouraged to take income streams over lump sums.

Complexity of superannuation

Despite Australia's three pillars retirement savings system often being considered world's best practice, many areas of complexity exist on the periphery that detract from the efficiency of the system. While the simpler/better superannuation changes addressed some complexities, many still exist and new ones were even created as a result of the changes.

In addition to the issues highlighted earlier, there are a number of areas of inequity and unnecessary complexity within the Australian superannuation system which should be addressed. These include:

- The imposition of the employment rules for contributions after age 65. These requirements limit the ability for individuals to flexibly move into and out of employment and retirement after age 65 and make it impossible to move inheritances into superannuation if the recipient is not working. This is a particular issue for widows/widowers who should be encouraged to maximise their retirement savings to counter their greater longevity risk.

- Individual entering/leaving Australia who were temporary residents have an extremely complex system to negotiate which ultimately ends up with the individual paying tax on their Australian super well in excess of the highest marginal tax rates simply because they are temporary residents and no other reason.

- The lack of permanent CGT rollover relief for fund mergers and transfers is an impediment to fund consolidation and has a particularly detrimental effect on self-managed superannuation fund members who may wish to, or are forced to wind up their fund and move to a commercially provided fund. There is already a precedent for CGT relief where SMSFs are split on divorce.

- The definition of ‘Australian superannuation fund’ may disadvantage Australians travelling overseas for employment reasons for greater than two years even though it is their intention to return permanently in the future.

By addressing these issues the Australian superannuation system would be less complex, more equitable and easier to understand and engage with.

Taxation of superannuation death benefits

CPA Australia believes the tax treatment of all superannuation death benefits should be consistent for dependants and non-dependants.

The payment of death benefits to dependants after 30 June 2007 are tax free (with the exception of income streams to dependants under age 60), while the taxable component of death benefits paid to non-dependants is taxed at 15 per cent.

This provides arbitrage opportunities. For example, an individual knowing they are going to die will be able to take their superannuation benefit as a lump sum and pass it on to their adult children tax-free. On the other hand, where death is sudden and unforeseen, the benefit may still be paid to the adult children but it would be taxed at 15 per cent.

Strategies are also being promoted in the market to minimise this tax treatment. For example, re-contribution strategies where the taxable component is withdrawn over time and re-contributed as an undeducted contribution, effectively reducing the taxable component to nil. Or separating the taxable and tax-free components into separate superannuation funds with the tax-free component payable to the non-dependant/s on death and the taxable component to the dependants. These strategies create inequities within the system as the people with the knowledge and ability to seek out advice will benefit, while those who need it the most may miss out.

CPA Australia believes the tax treatment of superannuation death benefits needs to be reviewed in a holistic manner to ensure consistent and equitable treatment of payments to dependants and non-dependants alike. In particular:

- The taxation of all superannuation death benefits should be consistent, i.e. tax free.
- The current inconsistencies between the definitions of ’dependant’ in the SIS Act and the *Income Tax Assessment Act 1936* be removed by aligning the definition of ’child’ in the ITAA 1936 with that in the SIS Act.
- The appropriateness and utilisation of ‘anti-detriment’ payments be reconsidered
- The final payment of an income stream upon death to be treated as an income stream payment not a lump sum.

Recommendation:

CPA Australia recommends that the tax treatment of superannuation death benefits be made consistent and provide equitable treatment of payments to both dependants and non-dependants.