Comments on the Financial System Inquiry recommendations

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Introduction

The emphasis on fairness in the terms of reference for the inquiry is encouraging. Not just because fairness is good for consumers but because it is good for the whole system and society.

With the exception of Recommendation 32, overall the recommendations appear worthy of support. The comments made here are generally intended to add to rather than contradict the recommendations.

Comments on selected recommendations

1~8. Resilience

These recommendations appear sound. The interests of the whole system and of consumers must override the risk-reward calculus of narrow vested interests.

The importance of fairness needs to be constrained by the observation that warped perceptions of fairness can be destructive. An example is the notion, particularly prevalent in pre-GFC United States, that everyone should be able to own their own home. When this was taken to the extent of facilitating and encouraging imprudent lending it became a factor in the perfect storm of the confluence of vested interests on both sides of the table that ultimately jeopardised the entire financial system.

9. Objectives of the superannuation system

Yes, it is critical that the objectives of the superannuation system must be clear, undiluted and mandated, namely: *to provide income in retirement to substitute or supplement the Age Pension*.

Public calls are frequently made, for example, for some of the vast pool of superannuation funds to be forcibly diverted to public interests such as infrastructure development. Such concepts inherently intend to bypass the normal financial market processes and should be explicitly outlawed because they conflict with the sole purpose of providing retirement income for the individual superannuation fund account holder.

One of the subsidiary objectives listed is to *alleviate fiscal pressures on the Government*. The following are two key obstacles that need to be addressed along the way to meeting this objective:

1. Pension entitlement culture.
2. Excessive accessibility to superannuation capital in retirement.

Anecdotally it is evident that there is a common mindset in Australian society that the age pension is an entitlement for everyone who has worked and paid taxes. Some individuals will even go so far as giving money away so they can become eligible for the pension. These are also the sort of people who are not likely to participate in surveys about retirement income from superannuation. The government should take steps to educate citizens from a young age that their lifetime financial objective should be to become indefinitely self-funded in retirement. Not everyone can achieve that ideal and that is why the pension system exists. But the prospect of being on an age pension should be predominantly viewed as an outcome of misfortune or misjudgement rather than as the natural end point for everyone.

Access to superannuation is discussed in the following section.

11. The retirement phase of superannuation

The recommendation is good but should be expanded.

The current rules for access to superannuation are not sufficient to dissuade the spending of all of one's superannuation between preservation age and pension age. Hence the whole purpose of the system can be thwarted, and evidently often is, despite what the average results of surveys might suggest. The system needs to be changed to essentially prevent superannuation capital being consumed at an excessive rate. Significantly tighter rules in this area might encourage pre-retirees to work longer and save harder if they are forced to view their superannuation balance in terms of a long-term income stream rather than a lump sum to be consumed in advance of getting an age pension. The *working longer and saving harder* might not necessarily be to achieve a higher superannuation balance but rather to accumulate the savings outside of superannuation to meet the needs of the early stage retirement years lifestyle that is not unreasonably desired.

The report contains useful discussion about the lower than appropriate use of annuities for income in retirement. What wasn't discussed was the concept that government defined benefit schemes that pay a pension rather than a lump sum are essentially an annuity type scheme from the outset. Non-government workers don't currently have access to such options. The only element that is defined by the superannuation system is what is paid in. Avenues should be explored whereby consumers could gain access to superannuation schemes that are not accumulation account based with an undefined lump sum balance at the end but rather at least emulate in some fashion defined benefit pension schemes.

14. Collaboration to enable innovation.

This recommendation should be tempered by some counterbalancing realities regarding technology.

1. While the underlying complexity of the changes in technology has been increasing, the impact on the majority of individuals is more and more at the margins of day-to-day life.

2. It can be argued that the individuals who reap the greatest personal benefit from technological developments in the financial sector are those whose livelihood is organised crime.
3. Those who lose the most from technological developments in the financial sector are those individuals who become the victims of organised crime.

Hence the Innovation Collaboration should first and foremost be aimed at ensuring that the benefits and costs flowing from developments in the financial sector should flow in the right directions when considered on the level of individuals at the extremities rather than just considering the average.

The first point above can be illustrated by considering typical day-to-day Australian life in 1915, 1965 and 2015 in areas such as the following.

Long distance travel

Short distance travel

Household appliances

Transport and consumption of fresh food

Keeping cool in hot weather

Communication

Life-threatening diseases

In those first 50 years the change in day-to-day life was far more dramatic than the next 50. Day-to-day life in 1915 was rather primitive compared to 1965. But a typical Australian household in 1965 had most of the modern conveniences that are essential now but were absent in 1915 and most, such as cars and refrigerators, haven't functionally changed much since. The impact of technological changes is actually slowing, and in some cases (consider Concorde) is regressing.

The development in the financial sector that has arguably had the largest impact on day-to-day life has been the advent of credit cards, debit cards and, more recently, stored value cards. But that step change mostly occurred some decades ago. The more recent developments in financial sector innovation essentially allow the customer to be their own bank teller. This has been very convenient, except that it can also allow a criminal on the other side of the world to be the customer's bank teller.

Clearly the technological changes in the financial sector has been a boon for organised crime. Someone can now rob a bank without leaving home. The scale and the sums of money involved is enormous and unprecedented. And it happens every day. Since the face-to-face interaction between institutions and customers is now minimal it is also quite easy to be an imposter and even sell large assets such as houses and pocket the proceeds. This too is becoming more routine.

One of the greatest threats to organised crime is financial transparency. But again, a recent technological development has provided a safe haven in the form of crypto currency.

Not all innovation is good or is implemented in a way that is fair. Some innovations are foisted upon consumers whether they want them or need them or not. For example, contactless payment innovation has been implemented with no opt-out option for consumers. This imposes risks that disproportionately disadvantage

consumers, particularly those at the lower end of the socioeconomic spectrum.

Finally, it is important to conceptually make a distinction between innovation and changes in technology and to be mindful of the nexus between the two. Innovation in creating new financial products for example is largely a matter of imagination that is disconnected from changes technology.

Those who have the job to coordinate policy and regulatory response to innovation and technological change affecting the financial sector must be focused first and foremost on the types of challenges outlined above. It is only fair.

23. Facilitate innovative disclosure

The subject of advice and disclosure should not just focus on disclosure and communication of interests and risks. Restrictions should be imposed that severely restrict, or even prohibit, investment advice being given to a consumer that has the potential to effectively bankrupt them in the event of outcomes, within the realms of the investment (i.e. excluding circumstances such as job loss), that are plausible or foreseeable. The imposition of jail terms for the worst cases of financial misconduct should be increased.

32. Impact investment

This is a dangerous recommendation.

The concept of impact investing contradicts the stated objective of superannuation given on page 95. Impact investing within superannuation should be prohibited. This is because it cuts across the purpose of superannuation to provide for retirement income. It fails the sole purpose test.

The strong emotional subjects that come into play in the field of impact investing will inevitably distort judgement, whether by beneficiaries or trustees. What might be seen by some as a helpful meeting of money and opportunity can become a dangerous mix with disastrous results.

The problematic nature of impacting investing can be illustrated by the fact that one person's idea of moral and socially good investment is to another person something quite the opposite. Investing in base load nuclear power to reduce greenhouse gas emissions for example.

The subject of social impact investment is not straightforward. Microfinance is a success story of social impact investment. But there are also many examples where applying more money to a problem has only made things worse in the long run, (consider welfare dependency). The average investor will have limited capability for judging whether their money is going to actually make things better or worse, let alone whether it will provide them with a reasonable return for their retirement fund. The problem of obtaining sound financial investment advice would be compounded by the problem of obtaining sound social impact advice and trying to combine the two.

The purpose of superannuation must never be diluted by other interests, no matter how laudable and no matter whether the beneficiary consents or not. Impact investing has a place but that place is outside of superannuation.

41. Unclaimed moneys

In addition to this recommendation the following is suggested.

First of all, the definition of 'unclaimed' should be restricted to *exclude* accounts where the institution still has a relationship with the account holder via other accounts that records show are active. The test should be that the account holder is inactive, not just the account. The rules should also encompass the requirement that all reasonable efforts (whether by the institution or ASIC) through all available channels of communication (e.g. online account messaging, email, letter, telephone) have been used to attempt to make contact.

Part of the problem with the existing system is that the test of 'unclaimed' is too loose. One consequence of this is that a great deal of administrative effort is wasted on reclaiming money that should never have been deemed to be 'unclaimed'. The other consequence is that individuals, and volunteer organisations in particular, can inadvertently lose funds to unclaimed moneys without realising it because the normal prompts such as online records just disappear with little or no trace. The money can potentially be lost indefinitely when otherwise it would inherently be rediscovered in the normal course of events. If and when it is discovered as missing then the problem returns to the first point above.

44 *Corporations Act 2001* ownership restrictions

Ownership restrictions, whether ASX or other key infrastructure and assets, whether financial sector or otherwise, should include prohibition of ownership being under the ultimate control of a foreign government.

General Comments

Parasitical industries

Further to the statement in the overview that *the focus of financial system policy should be primarily on the degree of efficiency, resilience and fairness the system achieves in facilitating economic activity, rather than on its size or direct contribution to the economy*, the following recommendation is suggested.

Within the financial industry are segments that that extract wealth but do not contribute to the real economy in any meaningful way or provide a service to anyone. A typical example is the preponderance of derivatives market players who are not engaged in risk transfer or investment but are engaged in a form of gambling to extract profit out of the system and do so only at the expense of others. Measures should be implemented to restrict the scope and growth of parasitical industries.

Restriction of payment choice

National regulations should be implemented that prohibit practices such as those which unreasonably restrict the method of payment available to consumers for essential services. An example is the practice in some states of forcing tenants to

subscribe to a rental payment system and not permitting any alternative. Another example would be the potential prospect of banks using their power to force all customers onto internet banking by, for example, ceasing cheque processing services. Fairness should include fairness in risk and accessibility.

Ageing population

The report makes repeated mention of an ageing population but makes no mention of the fact that this is a temporary demographic anomaly that mathematically must eventually cease. When new entrants into the system today eventually reach their retirement the demographic profile of the nation will be entirely different.

Australia should plan and prepare for a time when the demographic profile becomes static.

GDP and population growth

For the average individual the total GDP of the nation, or GDP growth, is a figure of little meaning or value. Hence neither should total GDP or overall GPD growth be of interest to national policy makers. However the GDP *per capita* is an indication of the relative prosperity of the nation, and this affects everyone. It is noted that the GDP per capita of Japan has been increasing in recent years while the population has been decreasing. Even if the overall GDP is reducing, so long as GDP per capita is increasing then at the level of the average of individuals the nation is becoming wealthier.

One area where this intersects the financial sector is the dependence on importing capital as mentioned in Chapter 1. Part of the reason for this dependence must be the need to continually expand infrastructure to cater for a growing population. This might create local jobs in the short term but the debts must be repaid with interest in the long term.

Population growth should not be an objective of government. The objective should be to move towards a stable and then reducing population all the while maintaining a steadily increasing GDP per capita. The policy settings of the financial sector should be geared towards maximising GDP per capita and not based on the assumption of, or a need for, a continuously growing population.

About the author

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