



Institute of Actuaries of Australia

**2006 PRE-BUDGET SUBMISSION
TO THE COMMONWEALTH GOVERNMENT**

11 November 2005

The Institute of Actuaries of Australia
ABN 69 000 423 656

Level 7 Challis House 4 Martin Place
Sydney NSW Australia 2000

Telephone 02 9233 3466 Facsimile 02 9233 3446

Email: actuaries@actuaries.asn.au Web site: www.actuaries.asn.au

INTRODUCTION

Economic and social issues arising as a result of Australia's ageing population are now resonating with business and the community at large. Concerns about these issues are reflected widely in the general media as well as in specialist business and professional publications and will, increasingly, demand detailed responses from governments in Australia. Actuaries are well placed to bring clarity to such issues and help governments meet the practical challenges associated with long-range forecasting of fiscal and social outcomes.

The Institute of Actuaries of Australia (Institute) represents a profession that has much to offer in this field as well as in the development and assessment of national policy in areas such as national savings, retirement incomes, financial reporting and corporate sustainability.

The actuarial profession in Australia has demonstrated its commitment to workable policy solutions in the national interest – most recently in areas such as medical indemnity insurance, general insurance regulation, the development of a national long term care scheme for people with catastrophic injuries, and workers compensation. The Institute has also been relied on by Government for its advice on projections on the adequacy of retirement incomes.

In this submission, the Institute focuses on the following areas of Government policy and actuarial involvement:

- A. Retirement incomes policy
- B. Financial reporting,
- C. Regulatory issues in the financial services sector
- D. Research initiatives

A. RETIREMENT INCOMES

1 Superannuation Tax Simplification Taskforce

The Institute has established the task force with a view to developing a model for a simplified tax system for superannuation. We hope to submit this model to the Government, for discussion and consideration, during the first quarter of 2006.

The Institute believes there are many reasons why the Government should continue the process of overhauling and improving Australia's superannuation system, with the aim of making it more efficient, more comprehensible and more accessible.

Re-emergence of the public debate on tax reform, unacceptable complexity of the present system and growing urgency as the Australian population ages, all underpin the desirability of simplifying the superannuation tax system and making it more attractive to existing and future investors.

Recent Government initiatives, including co-contributions, portability, choice of fund, contribution splitting, transition to retirement and, in particular, removal of the superannuation surcharge, have re-invigorated interest in superannuation savings, paving the way for the next set of reforms which should, we believe, aim at further increasing informed participation and comprehensibility. We believe these goals can be achieved by;

- moving taxes from the “front end” to the “back end” ,
- minimising impacts on government revenues by transitional arrangements, and
- simplifying the tax deductibility of contributions and taxation of benefits and avoiding the complexities associated with cumulative grandfathering of various past tax concessions and benefit options. This would be achieved by introducing a single step (ie once only) transition for all accrued rights.

As you are aware, the current superannuation tax system is enormously complex, involving;

<p>Contributions</p> <ul style="list-style-type: none"> ▪ 3 regimes for tax deduction ▪ 2 tax systems inside a fund <p>Investment Income</p> <ul style="list-style-type: none"> ▪ 2 tax regimes inside funds 	<p>Benefit Limits</p> <ul style="list-style-type: none"> ▪ 3 regimes <p>Benefit Payments</p> <ul style="list-style-type: none"> ▪ Lump sums: <ul style="list-style-type: none"> - 11 different tax rates ▪ Pensions <ul style="list-style-type: none"> - Taxed as income but 2 different kinds of rebates
---	--

The Institute’s proposed model will, when completed, provide for a much simpler tax regime, dramatically reducing the number of different regimes currently operating

2 Equity Release Schemes in Australia

Given the ageing population, and the relative recency of reasonably funded superannuation arrangements, many Australians retire with insufficient available assets to fund their retirement income. For those people who have significant equity in their family home, but are ‘income poor’, consideration of shared equity or equity release (reverse mortgages) is receiving increasing attention.

The Institute is, therefore, currently working on a report on equity release schemes ie financial arrangements which facilitate older people in accessing the equity in their homes while allowing them to continue living in those homes.

The reverse mortgage is the best-known example of an equity release scheme.

The Institute is of the view that a report on the operation, rationale and risks associated with these schemes is needed if governments, consumers and product providers are to avoid adverse outcomes in the future, by ensuring that equity release schemes are properly understood by all parties and effectively regulated. While such products are increasingly available the risks, particularly in relation to longer term outcomes, social security entitlements, taxation etc have not been adequately explored in Australia.

The Institute's report will cover:

- The need for equity release products in Australia
- How that need may develop in future
- Current state of development of the market in Australia
- Impediments to the development of the equity release market
- Actions that the Government could take to remove market impediments
- Risks that consumers could face with equity release schemes and ways that such risks might be mitigated
- Attractiveness of the market to product providers
- Strengths and weaknesses of the regulation of the equity release market and recommendations for changes to it.

While equity release products have been present in other markets (notably the UK) for some time, they remain relatively unknown in Australia. Notwithstanding the substantial accumulation of retirement savings by Australians under our compulsory superannuation savings system, it is quite possible that many older Australians will turn to equity release products in the future, when trying to sustain or increase living standards in retirement. The high proportion of Australian wealth tied up in residential property, combined with an ageing population and rising healthcare costs, could see a rapid rise in the equity release market in coming years.

The Institute, therefore, believes that the equity release marketplace is worthy of detailed analysis and looks forward to providing the Government with useful data and recommendations for regulatory and policy settings.

B. FINANCIAL REPORTING AND RISK & CAPITAL MANAGEMENT

Meaningful, complete, reliable and accessible financial reporting is critical for the sustainability of the corporate and financial services sectors, and for overall economic outcomes for Australia, in terms of both:

- Access to global capital and the appropriate and efficient allocation of capital within the economy; and
- Protecting the public interest and the economy against potentially severe consequences of corporate failures.

Addressing these needs requires consideration of both:

- The soundness of general purpose financial reporting, particularly in terms of meaningfulness and consistency; and
- Effectiveness and efficiency of risk management and allied capital reserving and management.

Growing reliance on the actuarial profession in these areas means that the Institute is uniquely placed both to identify concerns and to develop options for addressing problems. The Institute continues to work effectively with APRA in maintaining Australia's high standards and international leadership in these areas and appreciates the support provided by the Government.

1 International Accounting Standards

As previously noted to Government, the Institute supported the need for Australia to adopt high quality international financial reporting standards (IFRS) to assist Australian businesses gain access to the worldwide capital markets to the benefit of the Australian economy. However, for this outcome to be realised, it is necessary for IFRS to be well regarded by their users. Therefore IFRS must actually be uniform, high quality standards and have a predictable and meaningful basis of application.

Nonetheless, as also previously communicated, the Institute is concerned that the current suite of IFRS are not of a uniform, high quality standard.

Areas of significant concern in the financial services sector include:

- "Financial asset" and "financial liability" reporting options and restrictions under IAS39 (AASB139) and pension fund reporting options under IAS19 (AASB119).
- Inconsistent treatment of financial assets and financial liabilities under IAS39 (AASB139) and further inconsistency between these and insurance liabilities under AASB1038 and AASB1023.
- Treatment of "treasury shares" impacting funds management reporting.

- Anomalous and distorting treatments of funds management product fees under some modern business models.
- A comprehensive IFRS for insurance contracts does not currently exist and is unlikely to be available until at least 2009. Until then there will be no uniform insurance IFRS.
- While adopted in a number of jurisdictions, IFRS are not applicable in many others (e.g. the USA).

The key point from this is that the objectives of adopting IFRS are far from satisfied and there remain a number of years of significant work ahead to develop and enhance IFRS to achieve an acceptable uniform, high quality set of standards, including an insurance IFR Standard. Ultimately, we should be aiming for convergence of standards between the IASB and the American FASB. We should also try to ensure that the agreed interpretations of IFRS properly takes into account Australia's business and economic environment and not become hostage to ill-considered or self-serving views of other larger or more vocal jurisdictions.

It is therefore imperative that relevant public institutions (eg, FRC, AASB, APRA, ASIC) be adequately funded and directed by Government to continue to represent Australian interests in the development of IFRS.

Australian businesses, business groups and relevant professional organisations should be encouraged and supported to actively engage in IFRS debates and developments. Where practical, Government should look to support Australian voices within important multinational firms (for example, auditing and market analyst firms). We note the Australian representative on the insurance working group of the IASB is an Australian actuary.

2 International Capital Standards

Regulators from various jurisdictions now work together closely in the development of international regulatory frameworks and international capital reserving and risk management standards. Significant progress has been made in relation to both banking and insurance standards.

Australia has world-class capital reserving and risk management standards and is a leader in the international developments. The Institute has played, and will continue to play, a significant role working with APRA in developing and implementing Australian standards.

3 Prudential Supervision and Capital Management – Funds Management

Regulation across the funds management industry has significantly improved in recent years, thanks to the success of an improved regulatory regime and significant efforts on the part of ASIC and the industry itself. Given the growing size and importance of the funds management industry, however, it is important that regulatory and risk

management regimes be subject to expert scrutiny and, if necessary, review so as to ensure regulation is:

- Adequate, for the purpose of providing reasonable assurance that the promises made to consumers (eg to provide value for fees charged, calculate unit prices fairly, avoid errors, fraud etc) are sustainable
- Consistent across the industry in the interest of maximising efficiency
- Implemented efficiently in the interests of minimising costs to businesses and consumers (and ideally in a way that protects and preferably enhances overall economic and shareholder value/returns).

An important part of such management/regulation is risk management assessment (including identification of risk and financial assessment and measurement of the consequences of risk) and fair implementation of complex financial contracts with consumers. Actuaries have a long history of playing an important role on both these fronts and are increasingly focusing on the study and management of risk, looking forward.

Actuaries are well placed to play a role both in providing input to a reassessment of the regulatory regime for the funds management industry and in ensuring the industry and its clients benefit from the best possible risk management assessment.

C. REGULATORY ISSUES IN THE FINANCIAL SERVICES SECTOR

1 Proposal to standardise assumptions for use in calculators

In light of its view as to the general usefulness of calculators to consumers, the Institute has recommended to ASIC that it facilitate development of industry-wide, standardised assumptions for use in conjunction with computer software and paper-based investment and superannuation calculators.

There are many potential pitfalls associated with developing and implementing standardised assumptions for use in various types of calculators and the Institute believes that identification and resolution of all issues will only be possible through a process which involves active participation by a representative range of industry, consumer and government stakeholders. In our view, all financial services stakeholders share an interest in ensuring that calculators operate in a manner which serves consumers over the long term, by educating them about the products and services they access and informing their decisions.

While a number of industry bodies are currently preparing standardised assumptions for use by their constituents, it is unlikely that any one organisation will achieve universal coverage. What the Institute has proposed, therefore, is a process whereby major industry and consumer representative bodies collaborate to devise, monitor and maintain a full set

of standardised calculator assumptions. We also advocate the setting up of a framework for facilitating universal adoption of the standardised assumptions.

Issues suggested for consideration as part of the project include:

- The need for agreement on universal standards for setting assumptions for calculators
- Consumer education issues
- The means of achieving universal adoption (eg joint code of practice, ASIC relief)
- Who will set the assumptions (eg a panel comprising the Institute of Actuaries Australia and the Australian Government Actuary, in consultation with industry and consumer bodies)
- Parameters for setting standardised assumptions
- Mechanism for review of assumptions
- Triggers for review of assumptions
- Which calculators and which assumptions should be covered
- Liability issues.

Bearing in mind the likely growth in importance of calculators for consumers who, for one reason or another, choose not to access professional advice, the Institute believes the process for developing universal assumptions should commence as soon as possible.

D. RESEARCH INITIATIVES

1 Workers compensation

Workers compensation is a significant part of the employment system in the Australian economy. It is a significant labour cost for employers and provides important protection for workers against injury or disease sustained at work.

There are numerous legislative systems and management approaches around Australia, and continuing controversy about the merits of particular approaches and the relative success of alternative schemes.

It is widely agreed that income replacement (generally weekly benefits) is the single largest cost driver in workers compensation and also that early return to work is the most critical factor that offers win-win for employers and workers. The Institute has initiated research to focus on the issue in workers compensation that, arguably, offers the greatest potential for sustainable improvement for both major stakeholder groups, the dynamics of 'return to work'. The research will aim at developing an understanding of the dynamics of return to work in workers compensation schemes, concentrating on the first 26 weeks after injury.

2 Health Financing

The Government's Intergenerational Report has been enormously successful in raising community consciousness and driving debate and informed comment on significant

issues affecting Australia's economic and social future. In this regard, the report echoes the Institute's 1999 "Financing the Ageing" Discussion Paper, which also tracked the consequences of fundamental demographic changes.

Both of these reports identified health financing as having the greatest impact on future living standards and human wellbeing.

The Institute expects, in the coming year, to examine 3 aspects of health financing;

1. Drivers of health inflation
2. Quantification of the impact of preventative health programs
3. Health savings programs (ie exploration of concepts relating to encouraging or mandating individual saving for health care).

3 Actuarial Research Centre of Australia (ARCA)

ARCA, an independent research facility, is being established by the Institute for the purpose of arranging accessible high quality, independent research that applies actuarial science to relevant issues of public significance. ARCA is a charitable trust with a governing Board, an accredited Research Committee and an Executive Director. The Board will have both a normal corporate governance role and an advisory role regarding the research to be conducted by the Research Centre. The Executive Director will lead the Research Centre, and will arrange funding, take ultimate responsibility for research projects and represent the Research Centre publicly.

The values that will drive ARCA are the quality, independence and relevance of the research it arranges.

ARCA's aim is to facilitate the practical application of actuarial research, either in its own right or in conjunction with other disciplines. In general, priority will be given to topics that add value to public policy debate and development within the Australian community, in areas that are related to the actuarial profession in the broadest sense. In this context actuarial embraces risk, uncertainty and probability, it implies a degree of financial, statistical or mathematical analysis, and it has an emphasis on the future.

ARCA also aims to make accessible, protect and conserve the research that is produced. This will be achieved through a variety of media such as publications, conferences, seminars and website pages. ARCA will also produce an annual research report.

Research undertaken or managed by ARCA will be independent but its research briefs will be relevant to the needs of sponsors.

ARCA will seek funds from several sources including sponsors of various kinds, trusts and foundations, corporations, individuals, competitive research grants (including government research grants) and research conferences. The initial emphasis will be on

partnerships between industry and ARCA, in order to give stimulus and substance to ARCA's capacity and its reputation for doing worthwhile research.

The Institute is keen to discuss research partnerships with the Government.

CONCLUSION

The Institute would welcome the opportunity to discuss the issues raised in this 2006 Pre-Budget Submission. Please contact the Chief Executive, Catherine Baldwin on catherine.baldwin@actuaries.asn.au or phone (02) 9239 6106.