

Funding Australia's Future

23 October 2015

Funding Australia's Future – Stage Three – Forum, 21 October 2015

Stage Three of the Funding Australia's research project was successfully launched on 21 October 2015 in Sydney by Rupert Jolley, Chief Advisor to Treasury Secretary John Fraser.

The Australian Centre for Financial Studies (ACFS) initiated Funding Australia's Future in 2012 to better understand the changing dynamics of the financial system and its impact on role in future economic growth. Early stages of the project analysed the interaction between suppliers of funds, financial sector participants, and end users throughout the economy. This research provided valuable input to the Financial System Inquiry (FSI) on how well Australia's financial sector serves the economy (especially households and business), and how effectively it links the sources and uses of finance for the benefit of Australian society. The latest stage of the project, launched in January 2015, explored three specific challenges to the financial sector highlighted by the Financial System Inquiry, Tax System Review and Intergenerational Report.

- ***Dividend imputation and the Australian financial system: What have been the consequences?***
Professor Kevin Davis
- ***Big and better data, innovation and the financial sector***
Dr Ian Oppermann
- ***Financial issues in retirement – the search for post-retirement products***
Professor Deborah Ralston

While quite diverse, each of the topics studied has a bearing on important issues for the future of the financial system and its role in serving the economy.

In his keynote address, Rupert Jolley noted the importance of evidence-based research in financial services, and the need for an ongoing dialogue between academics and industry. Jolley listed a number of examples where researchers had identified problems in the industry (including credit bubbles pre-GFC) but were unable to affect change. Jolley argued that we need to build a culture where research feeds directly into the industry, and where there is a robust approach to utilising this evidence. This is particularly important given financial services professionals often have a very specialised focus while researchers are able to look across the system and potentially identify interactions that may not be evident to practitioners.

One area where researchers are successfully challenging the dominant thinking is in fintech, particularly through analysis of crowd funding and its implications for shadow banking systems. Another way researchers can add value and challenge the dominant paradigm is by undertaking comparative analysis across jurisdiction. Jolley raised a question around issues of domestic focus and home bias, highlighting the opportunity to learn from overseas regulatory practices that Australia could consider.

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Jolley also outlined the three major pieces of policy work that Treasury is contemplating – implementation of the FSI recommendations, the Tax White Paper process, and the Review of Retirement Income Stream Regulation. The key objectives of the FSI – strengthening the economy by ensuring the resilience of the financial system, improving consumer confidence in the financial services sector, and enhancing regulatory competency and accountability will underpin this work.

Engagement with industry and researchers is essential to the success of these processes, said Jolley. There is much work to be done implementing the recommendations of the FSI, completing the Tax Review and undertaking the related Capability Review of ASIC and Productivity Commission inquiry into the effectiveness and competitiveness of the superannuation system. Making significant advances within the financial system will require understanding and consent from the community. To this end Treasury is seeking frank and fearless feedback on its proposals and has thus far been impressed with participants' willingness to put their personal positions aside and speak instead to the national interest.

Forums and research such as the Funding Australia's Future project are an important tool for bringing researchers and industry together, leaving their personal biases aside, and exploring the status, and future, of Australia's financial system.

Following the key note address each papers was introduced and discussed by expert panel.

Dividend imputation and the Australian financial system

Professor Kevin Davis

Panellists: Tony Pearson (moderator), Steve Lambert, Professor Graham Partington

Although a significant amount of research has been done on the topic of dividend imputation, Professor Davis finds in his paper that there is still insufficient evidence to fully weigh up the net benefits of imputation and its effects. Imputation appears to have provided significant benefits to the Australian economy through impacts on corporate behaviour; at the same time, it is unclear whether imputation has stimulated domestic physical investment. Shifting to a classical tax system (with a company tax rate which generated equivalent government tax revenue) may have adverse consequences for low tax-rate investors.

Because of imputation, Australia's overall tax rate on company income distributed as dividends is lower than that in many other OECD countries, despite a seemingly high corporate tax rate. The case for shifting away from an imputation system is not strong, given its beneficial effects on corporate financial policies.

In discussing the paper, panellists noted evidence that in addition to lowering the cost of capital for corporates in Australia, imputation credits are valued by the market (seen for example in structured buybacks). Despite comments by some market participants that the policy of imputation in Australia has a dampening effect on the growth or depth of bond market, panel participants felt there was insufficient evidence to warrant this view. Dividend imputation will remain a highly relevant area for research as the government continues to work on tax policy.

Big and better data, innovation and the financial sector

Dr Ian Oppermann

Panellists: Daniel Wong (moderator), David Link, Camille Blackburn



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Australia has a productivity challenge. For the services sector, which constitutes more than 70% of the economy, productivity improvements will be heavily influenced by data advances. Historic measures of productivity that focus on labour, materials and capital may be missing out on the advances brought about by big data. Perhaps data should be considered as a unit of production (currently primarily given freely by users). Bigger and better data can help solve complex, subtle, people-centric problems which are difficult to model. Often overlaying seemingly unrelated datasets will provide additional insights.

Australia currently has a relatively weak framework for understanding data – from a value perspective, but also in terms of the storage and protection of data, including personal financial data. Developing an accounting standard that would enable better understanding of the monetary value of data could benefit in advancing the appropriate storage, use, dissemination and protection of data. The value of data is becoming increasingly clear from large M&A transactions where companies such as Facebook are paying many multiples of revenue streams for start up companies, with the value coming through their users' data.

For industry, data advances will see financial services companies offer many more services (for example a bank can now see how a product's entire supply chain interacts). For Government there should be a focus on limiting the potential harms from data sharing – this discussion is still embryonic in Australia and much more research is needed around data breaches, profiling, portability, and creating appropriate data ecosystems. Australia's weak jurisprudence (particularly around data privacy) inhibits innovation as there is uncertainty about how regulators will react. The next phase of 'disruption' will occur when individuals understand the value of their data and start charging for access to it. New businesses along the lines of "data banks" are starting up overseas – secure modes of storing and then charging for use of data may be not far off in the future.

Financial issues in retirement

Professor Deborah Ralston

Panellists: Jeremy Duffield (moderator), David Cox, Pauline Vamos

The 'baby boomer' generation will be the healthiest and wealthiest ever generation of retirees. As the cost of providing services to retirees grows, governments are increasingly looking to self-funding retirees to increase their level of self-funding, and to bear the costs of the retirement system. In some areas the financial sector is providing innovative products to meet retirees' needs.

However, there are many areas where financial products have not yet evolved to meet the needs of the next generation of retirees. These include products to smooth income and cover longevity risk; to ensure adequate income to cover the cost of aged care; to reduce the financial risks around major health events; and to ensure retirees can manage elevated health care costs as they age. It is estimated that retirees in the baby boomer generation may be using up to 20% of their income to cover their health care costs by the time they reach age 75.

The key to providing efficient financial products in retirement is risk pooling. As industry seeks to create new products, it needs clarity from government about how much of self-reliance retirees will be expected to have – issues such as the means test and asset test are critical. Industry also needs to be greater clarity on how new products will be regulated. The development of more retirement income stream products will require a

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greater scale in the market – big capital, lots of innovation and a massive use of data. Finally, these interactions between retirement income, advice, accommodation and healthcare are inextricably linked. The Government may consider introducing a group of experts to formulate views on the interaction between these services, alongside behavioural issues.

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About Funding Australia's Future

Funding Australia's Future is a long-term project that assesses future demand for and supply of finance in Australia and identifies challenges for the financial system and policy makers in ensuring efficiency in the flow of funds process.

The Funding Australia's Future project analyses the interaction between financial sector participants, end users and suppliers of funds. In doing so the project builds an evidence base to understand how changes in one area of the financial sector can impact other participants.

Such an evidence base provides invaluable support for policy decision makers and for financial sector participants in identifying future needs and strategic opportunities.

Critical to Funding Australia's Future is the partnership with leading companies and organisations, key stakeholders of the financial system who provide input to the project. For more information, please [click here](#) .



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Stage One

The three papers in Stage One were released in July 2013 and provide an evidence base on the current state of the Australian financial system, how it has evolved over the last 10 years and how it is likely to change in the future. The papers also provide an overview of the regulatory and financial infrastructure that governs the system.

- [*From Where Do We Begin?*](#) Professor Kevin Davis
- [*The Future Demand and Supply of Finance*](#) Professor Rodney Maddock and Peter Munckton
- [*Improving Australia's Financial Infrastructure*](#) Dr Daniel Mulino

Stage Two

Stage Two of the project is made up of four papers released in July 2014 that drill down into the issues identified in Stage One of the project and culminate in a set of recommendations for improving Australia's Financial System.

- [*Financing the Australian Business Sector*](#) Dr Sam Wylie
- [*Australian Household Sector Finances*](#) Professor Michael E. Drew and Dr Adam N. Walk
- [*International Linkages: Financial Markets and Technology*](#) Professor Deborah Ralston and Mr Martin Jenkinson
- [*Regulating the Australian Financial System*](#) Mr Alex Erskine

Stage Three

Stage Three of the project comprises three papers released in October 2015. The papers explore three specific challenges to the financial sector highlighted by the Financial System Inquiry, Tax System Review and Intergenerational Report. Though diverse, each of the topics in Stage Three has a bearing on important issues for the future of the financial system, and its role in serving the economy.

- [*Dividend imputation and the Australian financial system: What have been the consequences?*](#) Professor Kevin Davis
- [*Big and better data, innovation and the financial sector*](#) Dr Ian Oppermann
- [*Financial issues in retirement*](#) Professor Deborah Ralston