

News in Review August 2018

Governance and legislation update

Government passes Asia Region Funds Passport legislation

The Australian funds management industry should gain access to a far larger market, thanks to the passage of the Asia Region Funds Passport legislation in late June, which the Federal Government (Government) expects to “open the gateway to the Asia region’s financial services market”. The Passport enables a fund registered in one country to be sold to retail investors in other participating countries, which include Australia, Japan, Korea, Thailand and New Zealand.

Federal Revenue and Financial Services Minister Kelly O’Dwyer commented that the Passport would provide Australian fund managers with an opportunity to gain economies of scale through selling to Asia’s growing middle class. She added that while Australia has one of the world’s largest and most sophisticated funds management industries — looking after \$3 trillion of assets under management — only around 4% of these funds belong to people outside Australia.

“The Asia Region Funds Passport is one of the Government’s initiatives to improve outcomes for consumers by providing them with greater choice of products and increased competition. It will also offer Australian fund managers an opportunity to gain economies of scale through selling to Asia’s growing middle class,” she said.

“Australian investors will also benefit through greater choice of funds and increased competition, which in turn will ensure access to more reasonably priced investment products, as well as boost Australia’s services economy.”

The Corporations Amendment (Asia Region Funds Passport) Bill 2018 gives effect to the *Memorandum of Cooperation on the establishment and implementation of the Asia Region Funds Passport* signed in 2016 by Australia, Japan, Korea, New Zealand and Thailand. The passage of the Bill is considered an important milestone in Australia’s implementation of the Asia Region Funds Passport, with associated regulations currently under consideration.

According to O’Dwyer, this consultation will enable the regulations to be made and commence together with the Passport legislation when it receives proclamation. This will be the final step in the Government’s delivery of its commitments set out in the Passport Memorandum of Cooperation.

The Financial Services Council (FSC) welcomed the passage through Parliament of legislation to implement the Asia Region Funds Passport, but warned that tax reforms to complement the Passport are now urgent.

“The Government now needs to act without delay to address Australia’s complicated withholding tax regime which acts as a barrier to retail, or mum and dad investors, from investing in Australian funds,” FSC CEO Sally Loane said.

“Australia, unlike other countries in our region, has a complicated non-resident withholding tax regime which means we will not be able to compete with countries where this rate is zero.”

The Passport was one of the recommendations of a 2009 review by veteran fund manager Mark Johnson — author of *Australia as a financial centre: Building on our strengths*, or Johnson Report — to position Australia as a global financial centre.

FASEA releases draft Financial Adviser Examination guidance

The Financial Adviser Standards and Ethics Authority (FASEA) released proposed guidance on the Financial Adviser Examination in July, describing the examination as “an essential component of the educational qualifications that all advisers will need to pass before they can provide personal advice to retail clients”.

Advisers that are registered as authorised representatives prior to 31 December 2018 will be required to pass the examination before 1 January 2021. From January 2019, new entrants or those returning to the industry are required to pass the exam after they have completed their tertiary degree, and before commencement of their professional year.

FASEA proposes that the exam will test the practical application of adviser knowledge in the following competency areas:

- *Corporations Act 2001* (Corporations Act) (emphasis on Chapter 7 — Financial services and markets)
- The FASEA Code of Ethics
- Behavioural finance — client and consumer behaviour, engagement and decision making
- Financial advice construction — suitability of advice aligned to different consumer groups
- Applied ethical and professional reasoning and communication

The guidance also proposed that the exam should have a mix of multiple-choice and short-answer questions. Advisers will be given up to two opportunities to re-sit the exam. FASEA further advised that the remaining standards would be released in the coming weeks.

This followed four consultation forums with key stakeholders during May. The forums included contributors, licensees, educators and industry associations to ensure a wide range of views were represented in the consultation process.

The forums gave guidance on FASEA’s role in establishing draft standards, as well as seeking feedback on specific elements of FASEA’s proposed guidance for adviser education pathways and the industry code of ethics.

Economic and central bank update

Cash rate steady as RBA notes tighter lending standards

The RBA left the cash rate on hold again in early July, but an increase in funding costs has led to some lenders raising home loan interest rates anyway. In its sixth meeting of the year, the RBA Board agreed to leave the cash rate on hold at 1.50% — the 21st meeting in a row that the central bank has held rates steady.

RBA governor Philip Lowe noted that nationwide measures of housing prices were little changed over the past six months.

“Conditions in the Sydney and Melbourne housing markets have eased, with prices declining in both markets. Housing credit growth has declined, with investor demand having slowed noticeably,” he said.

“Lending standards are tighter than they were a few years ago, with APRA’s supervisory measures helping to contain the build-up of risk in household balance sheets. Some further tightening of lending standards by banks is possible, although the average mortgage interest rate on outstanding loans has been declining for some time.”

Lowe added that the low level of interest rates is continuing to support the Australian economy.

“Further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual,” he said.

“Taking account of the available information, the Board judged that holding the stance of monetary policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time.”

Industry update

SMSF advice needs ‘significant improvement’: ASIC

ASIC has put financial advisers who advise SMSF trustees on notice after reviewing a sample selection of client files. The regulator reviewed 250 client files randomly selected based on ATO data, and assessed compliance with the Corporations Act’s best interests duty and related obligations. In 91% of files reviewed, the adviser did not comply with Corporations Act’s best interests duty and related obligations.

ASIC deputy chair Peter Kell said the standard of advice on SMSFs must improve and that the financial advice sector had “significant work to do” to lift their performance in this area.

According to ASIC, the non-compliant advice ranged from record-keeping and process failures to failures likely to result in significant financial detriment. In 10% of files reviewed, the client was likely to be significantly worse off in retirement due to the advice. In 19% of cases, clients were at an increased risk of financial detriment due to a lack of diversification.

Commenting on the report, FPA CEO Dante De Gori, stated that SMSFs were not suitable for everyone.

“There is no doubt that these results will focus the efforts of Code Monitoring Bodies, once approved, on the proactive supervision of SMSF advice. This is a growing sector and good advice is imperative to ensure the best outcomes for those who choose an SMSF as the vehicle to manage their retirement savings,” he said.

The FPA supported the practical tips developed by ASIC and encouraged all financial advisers giving SMSF advice to review their handling of the role and obligations of SMSF trustees, the suitability of an SMSF structure, risks of an SMSF structure, investment strategy, alternatives to an SMSF structure, and record-keeping.

The SMSF Association saw the ASIC review as an important signal to the sector that the quality of financial advice provided to SMSF members was crucial to the integrity and performance of the industry.

“The pockets of poor advice provided to SMSF members are concerning, especially given the important role financial advisers play in assisting SMSF members with their retirement savings,” SMSF Association CEO John Maroney said.

Maroney added that inappropriate SMSF advice provided by “property one-stop shops” was of special concern to the SMSF Association.

“Where SMSFs are investing in property and using gearing to do so, it is essential that this be considered in a broad retirement savings strategy in the best interests of the individual,” he said.

“SMSF advisers should not shy away from scrutiny of the sector but see it as an opportunity to strengthen advice practices. We encourage advisers to read the report and the information ASIC has provided on ‘practical tips’ that can be used to improve advice delivered to SMSF trustees and compliance with the relevant advice laws.”

One in six consumers struggling with credit card debt

ASIC’s review into credit card lending in Australia has found that 18.5% of consumers are struggling with credit card debt. ASIC reviewed 21.4 million credit card accounts open between July 2012 and June 2017.

Report 580 *Credit card lending in Australia* (REP 580) released in July, found that while credit cards offer flexibility, they can present a debt trap for more than one in six consumers. In June 2017, there were almost 550,000 people in arrears, an additional 930,000 with persistent debt and a further 435,000 people repeatedly repaying small amounts.

“Our findings confirm the risk that credit cards can cause financial difficulty for many Australian consumers,” ASIC deputy chair Peter Kell said.

According to the regulator, consumers are also being provided with credit cards that do not meet their needs. For instance, many consumers carry balances over time on high-interest-rate products, when lower-rate products would save them money. ASIC estimates that these consumers could have saved approximately \$621 million in interest in 2016/17 if they had carried their balance on a card with a lower interest rate.

“Only a handful of credit providers take proactive steps to address persistent debt, low repayments or poorly suited products,” Kell said.

“There are a number of failures by lenders to act in the interests of consumers and we expect them to respond swiftly to our findings. We will be following up to ensure the problems we have identified are addressed, including public updates later this year.”

ASIC also looked at balance transfers and their effect on debt outcomes. The data shows that while many consumers reduce their credit card debt during the promotional period of transfer to a new card, a concerning number of consumers increase their debt. The research found that over 30% of consumers increased their debt by 10% or more after transferring a balance.

On 16 December 2015, the Senate Economics References Committee released its report relating to credit card interest rates, Interest rates and informed choice in the Australian credit card market. A primary concern of the Committee was that too many Australians are ‘revolving’ credit card debt for extended periods of time while paying high-interest charges.

In March 2018, the Government implemented the first phase of reforms in response to the Senate Inquiry. These reforms will help prevent future consumers from experiencing problem credit card debt by:

- ensuring that credit providers assess a consumer’s ability to repay a credit card limit over a period prescribed by ASIC
- banning unsolicited credit limit increase invitations
- making it easier for consumers to cancel credit cards.

ASIC also issued *Consultation Paper 303 Credit cards: Responsible lending assessments* which proposes responsible lending assessments for credit cards be based on whether the consumer can afford to repay the credit limit within three years.

Market snapshot

REP 580 found that as of June 2017, there were 14 million open credit card accounts, an increase of over 300,000 since 2012.

Other interesting points include:

- outstanding balances totalled almost \$45 billion.
- approximately \$31.7 billion in balances on credit cards that were incurring interest charges.
- consumers were charged approximately \$1.5 billion in fees in 2016/17, including annual fees, late payment fees and other amounts for credit card use.
- around 62% of consumers had only one credit card between 2012 and 2017.
- consumers with multiple cards generally had two cards.
- fewer than 5% of consumers had five or more credit cards between 2012 and 2017.

ASIC accepts court enforceable undertaking from CBA

CBA has entered into a court enforceable undertaking with ASIC in relation to its bank bill trading business and participation in the setting of the Bank Bill Swap Rate (BBSW), a key benchmark and reference interest rate in the Australian financial system. As part of

the undertaking, CBA will pay \$15 million to be applied to the benefit of the community, and \$5 million towards ASIC's investigation and legal costs.

The bank will also engage an independent expert to assess changes CBA has made (and will make) to its policies, procedures, systems, controls, training, guidance and framework for the monitoring and supervision of employees and trading in Prime Bank Bills.

On 21 June 2018, the Federal Court in Melbourne imposed pecuniary penalties totalling \$5 million on CBA for attempting to engage in unconscionable conduct in relation to BBSW. CBA admitted to attempting to seek to influence where BBSW was set on five occasions in the period 31 January 2012 to 15 June 2012. The bank also admitted that it failed to do all things necessary to ensure that it provided financial services honestly and fairly and that its traders were adequately trained.

Justice Beach of the Federal Court noted the terms of the court enforceable undertaking and, in imposing the pecuniary penalty of \$5 million, stated:

... that sum together with the other payments all totalling \$25 million should be an adequate denouncement of and deterrence against the unacceptable trading behaviour of individuals within CBA that ought to have known better and a bank that ought to have better supervised its personnel.

ASIC commenced legal proceedings in the Federal Court against CBA on 30 January 2018, alleging that on three specific occasions between 31 January 2012 and October 2012, CBA traded in a manner that was unconscionable and created an artificial price and a false appearance with regard to the market for certain financial products that were priced or valued off BBSW.

This followed proceedings in the Federal Court against ANZ on 4 March 2016, against Westpac on 5 April 2016 and against NAB on 7 June 2016. On 10 November 2017, the Federal Court made declarations that each of ANZ and NAB had attempted to engage in unconscionable conduct in attempting to seek to change where the BBSW set on certain dates and that each bank failed to do all things necessary to ensure that they provided financial services honestly and fairly. The Federal Court imposed pecuniary penalties of \$10 million on each bank.

On 20 November 2017, ASIC accepted enforceable undertakings from ANZ and NAB, which provide for both banks to take certain steps and to pay \$20 million to be applied to the benefit of the community, and that each will pay \$20 million towards ASIC's investigation and other costs.

On 24 May 2018, the Federal Court found that Westpac engaged in unconscionable conduct under section 12CC of the *Australian Securities and Investments Commission Act 2001* by its involvement in setting BBSW on four occasions. A further hearing of this proceeding on penalty and relief will be held on 12 October 2018. The Government recently introduced legislation to implement financial benchmark regulatory reform, and ASIC has consulted on proposed financial benchmark rules.

AMP called to account on 'rewriting conduct'

ASIC commenced proceedings in the Federal Court against AMP Financial Planning (AMPFP) in late June in relation to alleged failure by AMPFP to ensure its authorised

financial advisers comply with the best interests duty and related obligations under the Corporations Act.

The regulator alleges that certain AMPFP financial advisers engaged in 'rewriting conduct' — which is providing advice that results in the cancellation of the client's existing life, total and permanent disability, trauma and/or income protection insurance policies and the taking out of similar replacement policies by way of a new application rather than by way of a transfer.

By advising clients to submit new applications, the financial planners stood to receive higher commissions than they would have received under a transfer, while at the same time exposing the clients unnecessarily to underwriting and associated risks. ASIC alleges that this type of advice was inappropriate, and that the financial advisers failed to act in the best interests of the clients and to prioritise the interests of the clients.

ASIC contends that by 1 July 2013, AMPFP knew or ought to have known that its authorised financial planners were (or there was a risk that they were) engaging in rewriting conduct and the detriment this conduct caused to the clients, yet in the period from 1 July 2013 to 30 June 2015 AMPFP failed to take reasonable steps to deal with the conduct in contravention of section 961L of the Corporations Act.

In support of this allegation, ASIC will rely upon a number of sample client files in which it alleges rewriting conduct occurred. The sample files involve current and former AMPFP authorised financial advisers including, among others, Rommel Panganiban, who was permanently banned by ASIC from providing financial services in September 2016, with that decision affirmed on appeal by the Administrative Appeals Tribunal last year.

Section 961L is a civil penalty provision, and attracts a maximum penalty of \$1 million per contravention.

ASIC will also allege that AMPFP has breached sections of the Corporations Act which require a licensee to ensure that the financial services covered by its licence are provided efficiently, honestly and fairly; to comply with financial services laws; and to take reasonable steps to ensure that its representatives comply with the financial services laws.

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