News in review

March 2018

What's made news recently?

- Legislation update
  - APRA's powers increased
  - Banking Executive Accountability Regime comes into force
  - Government cracks down on credit card practices
  - Single financial complaints authority now a reality
- Economic and central bank update
  - RBA keeps interest rate at 1.5%
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  - CFP membership reaches record global high
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  - New Payments Platform launches after delay
- Market regulators' reports and guidance
  - ASIC report severely critical of vertical integration.

Knowledge areas and accreditation
Knowledge areas: Generic Knowledge (30 minutes/0.5 points), Generic Knowledge — Legal Environment and Compliance (30 minutes/0.5 points). FPA CPD points: 1.0, Dimension: Capability (FPA 009875). AFA CPD points: 1.0 (AFA 01022009). CPA Australia CPD points: 1.0 (CPA 000504). FBAA CPD points: 1.0. TPB CPE (60 minutes/1.0 point). SMSF Association CPD points: 1.0.

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Learning objectives

After reading this article, you should be able to:

- discuss the current state of the financial services industry
- highlight factors influencing monetary policy
- outline the key legislative reforms from February
- explain ASIC's findings about vertical integration.

Legislation update

APRA's powers increased

APRA's crisis management powers have been strengthened as part of raft of legislation purported to improve Australia's financial system.

On 14 February 2018, the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 was passed by the Senate. Based on a recommendation from the Financial System Inquiry, the Bill provides:

- clear powers that enable APRA to set requirements on resolution planning and ensure banks and insurers are better prepared for a crisis; and
- an expanded set of crisis resolution powers that equip APRA to act decisively to facilitate the orderly resolution of a distressed bank or insurer.

"International experience during the [global financial] crisis demonstrated that regulators also need powerful, flexible and timely tools to resolve financial institutions in distress," Treasurer Scott Morrison said.

He added that the prudent time to strengthen powers was when the financial system was healthy.

Banking Executive Accountability Regime ready to come into force

The Banking Executive Accountability Regime (BEAR) legislation was passed by the Senate on 7 February 2018 and is due to come into force from 1 July 2018 for large authorised deposit-taking institutions (ADIs).

BEAR stipulates that when obligations are not met, APRA will be able to impose large fines on individual executives and/or disqualify them. It will also ensure that remuneration policies result in financial consequences for individuals.

“Banks will be required to register their senior executives and directors (accountable persons) with APRA and provide greater clarity regarding their responsibilities,” Treasurer Scott Morrison said.

“These measures will incentivise good behaviour and ensure that banks and individuals are held to account where they fail to meet the standards expected of them.”

For small to medium ADIs, BEAR comes into effect from 1 July 2019 to give them time to comply as they lack the operational resources of their large counterparts. The Treasurer has also proposed that the Federal Government will develop a legislative instrument defining small, medium and large ADIs for the purpose of the BEAR, and that the Government will consult with industry.

Government cracks down on credit card practices

Affordability assessments of customers’ ability to repay the credit limits within a reasonable time are to be mandatory for credit card providers from July 2018.

The Treasury Laws Amendment (Banking Measures No. 1) Bill 2017 was passed by Federal Parliament on 15 February 2018 and includes several reforms to credit card practices and banking.

Example

From January 2019, unsolicited offers to increase credit card facility limits are banned, credit card interest calculations will be simplified, and credit cards providers need to provide an online option to cancel cards or reduce limits.

“This legislation will protect vulnerable Australians from predatory behaviour which seeks to make a quick buck from people's misfortune, and compound their financial hardship. This is the first phase of reforms outlined in the Government's response to the Senate Inquiry into the credit card market, which seeks to put more power in the hands of consumers,” Treasurer Scott Morrison said in a statement.

The Bill also loosens regulations so that any ADI license holder can call itself a bank, in a bid to improve competition by enticing new lenders and challengers to enter the market.

Finally, this Bill strengthens APRA’s influence by giving it a reserve power over non-banks’ lending activities. The new power enables APRA to make rules relating to the provision of finance by non-ADI lenders in circumstances where it has identified material risks of instability in the Australian financial system.

Single financial complaints authority now a reality

The much-anticipated “one-stop-shop” for financial complaints is now a reality after the Government passed legislation on 14 February 2018 to create the Australian Financial Complaints Authority (AFCA).

It will be a consolidation of the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal (SCT).

The *Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Legislation will* give more consumers and small businesses access to “free, fast and binding” dispute resolution, the Government said in a press release.

“AFCA will provide a one-stop shop to ensure consumers get a fair deal in resolving disputes with banks, insurers, super funds and small amount credit providers, without the expense, inconvenience, and trauma associated with going to court,” Minister for Revenue and Financial Services Kelly O'Dwyer said in the release.

AFCA is the result of the Government implementing the central recommendation of the Ramsay Review, which handed down its findings into the financial system’s external dispute resolution and complaints framework in April 2017.

The review, led by Melbourne Law School’s Professor Ian Ramsay, recommended replacing FOS, the CIO and the SCT into one external dispute resolution body.

The AFCA will start accepting complaints by no later than 1 November 2018.

Economic update

RBA keeps interest rate at 1.5 %

The RBA has kept interest rates at the historic low of 1.5 %, as it announced on 6 February 2018.

Rates have been on hold since August 2016.

In a statement, RBA governor Phillip Lowe said inflation is low, with the consumer price index (CPI) and underlying inflation running at 1.9%.

Lowe and Treasurer Scott Morrison have put target inflation rate at between 2 and 3%, which the RBA said, “does not materially distort economic decisions in the community”.

With lower interest rates, people are likely to borrow more money and spend more, helping to stimulate the economy.

“Inflation is likely to remain low for some time, reflecting low growth in labour costs and strong competition in retailing,” Lowe said.

However, his outlook was optimistic, saying he expected inflation to pick up as the economy strengthens, with the central forecast for CPI inflation rising slightly above 2% in 2018.

The RBA’s central forecast is for GDP growth to average a little more than 3% over 2018/19.

Slow wages growth is also affecting the growth of the country's cash rate. In a February *Domestic Economic Conditions*, the RBA said growth on average wages remains low. Although RBA assistant governor Luci Ellis stated in a 13 February speech, "Three questions about the outlook", that the central bank does expect wages to grow gradually.

"While our forecasts for wage growth and inflation are also unchanged, there are some positive signs that make us a bit more confident that the expected pick-up in wage growth and inflation will eventuate," she said.

Another factor contributing to Australia's current interest rate is the country's unemployment level against the estimate for the non-accelerating inflation rate of unemployment (NAIRU), according to analysis in an article, "One simple chart explains why the RBA isn't hiking interest rates like other central banks", by former economist David Scutt in *Business Insider*.

The NAIRU is the level of unemployment that does not cause inflation to rise.

It is sometimes referred to as full employment, the condition where nearly all people who are able and want to work are employed.

"An unemployment rate above NAIRU leads to a slowing of inflationary pressures", Scutt said, while an unemployment rate below this level leads to acceleration.

In Australia, the RBA currently estimates the NAIRU at 5%, while the unemployment rate is at 5.5%.

In comparison, the OCED estimates the US' NAIRU at 4.9 % and the current unemployment rate is 4.1 %, hence the US Federal Reserve has been raising rates for more than two years since unemployment fell below the NAIRU.

New Fed chair sworn in

Jerome 'Jay' Powell, aged 65, was sworn in as the 16th chair of the US Federal Reserve System on 5 February 2018.

Powell, who has taken office on a four-year term, is also a chair of the Fed's principal monetary policymaking body, the Federal Open Market Committee.

Powell explained that the Fed would gradually normalise interest rates.

"We will also preserve the essential gains in financial regulation while seeking to ensure that our policies are as efficient as possible. "We will remain alert to any developing risks to financial stability," he said.

Inflation and unemployment in the US are currently at near-record lows. The CPI increased 0.5% in January, the US Bureau of Labor [sic] Statistics reported on February 14. Over the last 12 months, the All Items Index rose 2.1%.

The Fed has a target inflation rate of 2%.

The unemployment rate in the US is at 4.1%, according to the bureau, a significant decrease from 8.2% % in 2012 when Powell first joined the board. The US added 200,000 jobs in January 2018.

Powell was a partner at private equity firm The Caryle Group, and Barack Obama nominated him to the Fed's Board of Governors in 2011.

His predecessor, Janet Yellen, led the Fed from February 2014 until February 2018.

Industry update

CFP membership reaches record global high

The number of certified financial planners (CFPs) worldwide increased by 3.2 % to a record 175,573 around the world in 2017, the global certified financial planning licensing body, Financial Planning Standards Board (FPSB), reported.

Further, the FPSB found there was a total 15,726 more CFPs in 26 territories by the end of last year.

In February, FPSB CEO Noel Maye said the board aimed to increase the total number of CFPs to 250,000 in 40 territories by 2025.

In a press release of 13 February 2018, the Financial Planning Association of Australia (FPA) reported that 5,702 CFPs work in Australia.

"It is very important for Australians to know what to look for when they are seeking financial advice. The CFP designation is the gold standard in advice and research shows that people who work with a CFP professional generally feel more confident in achieving their financial goal, FPA CEO Dante De Gori said in the release.

The local figures were announced as Dr Mark Brimble resigned as chair of the Financial Planning Education Council (FPEC), an independent body established by the FPA in 2011 to raise the standard of financial planning education.

His resignation follows the Financial Adviser Standards and Ethics Authority (FASEA) announcement in October that it would adopt the FPEC's educational standard framework.

"The FPA board wishes to thank Mark for his outstanding contribution in helping to build FPEC and the work he has done to raise the standards of financial planning education since his appointment as chair in November 2013, " FPA chair Neil Kendall said in a press release.

From January 2019, new entrants to the financial advice industry will be required to complete an AQF7 bachelor degree.

Loans and credit cards first up for banking Royal Commission

Consumers allege Australia's financial services have acted on false documents and provided inappropriate financial advice, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services heard during its opening on 12 February.

"In many cases, perhaps very many cases, the fact that there has been misconduct, or conduct falling short of community standards and expectations, has been established previously or is now acknowledged or admitted," Commissioner Kenneth Hayne QC said at the inquiry on 12 February.

About 31% of the 385 public submissions to the inquiry regarded dealings with personal finance, 17% on superannuation, 13% small business finance, 12% mortgage brokers, and 9% financial advice, according to Counsel assisting the Commission, Rowena Orr.

The first round of hearings will commence in approximately one month's time, and will likely focus on credit products such as home loans, car loans and credit cards.

The $75 million inquiry is set to hear evidence from consumers about Australia's $1.63 trillion home loan market that suggests "consumers have not always enjoyed the right to be treated honestly and fairly" and where laws may have been broken, Justice Hayne said.

He added that some of the large financial institutions had not meet their 13 February deadline to provide more specific information about misconduct, including criminal behaviour and breaches of trust, that had potentially occurred over the past five years.

"It has been said that the deadline cannot be met because of the amount of material that has to be reviewed and then assembled," Justice Hayne said.

"What is to be drawn from the fact that requests for more time to give more specific information about events of misconduct identified over the last five years might have to be considered."

There have been questions about whether there's enough time to conduct the inquiry.

On 13 February, *ABC News* reported in a story, "What we did (or didn't) find out about the banking royal commission", the University of Western Australia Law School's Dr Andy Schmulow as saying that the timeline was "hopelessly too short and the scope is too narrow".

The Royal Commission is required to submit a preliminary report by 30 September and a final version by 1 February 2019.

New Payments Platform launches after delay

A new payments infrastructure that allows the instantaneous transfer of funds between banks, building societies and credit unions began its public rollout on 13 February 2018.

Originally expected to hit the market in October, the New Payments Platform (NPP) is being keenly watched by overseas institutions as it features:

- a layered architecture that can support multiple and competitive services
- significant data capability through the use of ISO20022
- an addressing service called PayID that enables payments to be made to simpler memorable identifiers rather than BSB and account numbers.
- real-time settlement via the RBA's Fast Settlement Service.

"This is the biggest thing to happen in the industry since the inception of internet banking 10 years ago. It's a great example of Australian banks leading the way for their customers," Australian Bankers' Association chief executive Anna Bligh said.

"The new PayID, launched over the weekend, will mean that remembering your BSB and account number will be a relic of the past with a simple identifier such as a mobile phone number able to be used to receive payments into your account,"

NPP Australia chief executive Adrian Lovney explained that most of 60+ financial intermediaries rolling out the instantaneous payments on the platform will use an overlay service called Osko, developed by BPAY, which in turn is owned by the big four banks.

Lovney added that the open access design will allow different entities to leverage the NPP's functionality in different ways,

"Innovative organisations can choose to build upon the platform's capabilities to develop and launch 'overlay services' on the Platform. These could be payments experiences, or they could be business applications that enable significant organisational efficiencies," he said.

Market regulators' reports and guidance

ASIC report severely critical of vertical integration

Vertically integrated firms were failing to properly manage conflicts of interest in financial advice, ASIC's Report 562 Financial advice *Vertically integrated institutions and conflicts of interest* revealed.

The regulator found that 75% of advice regarding switching superannuation did not demonstrate compliance with the duty to act in the best interests of their clients, of which 10% of the advice was likely to leave the customer in a significantly worse financial position.

The review looked at the products that ANZ, CBA, NAB, Westpac and AMP financial advice licensees were recommending and at the quality of the advice provided on in-house products between 2015 and 2017.

It also discovered that despite 79% of products on approved products lists being external, 68% of client's funds were invested into in-house products.

Acting ASIC chair Peter Kell Emphasised that the reglator was already working with the major financial institutions to address the issues that have been identified in the report on quality of advice and management of conflicts of interest.

"There is ongoing work focusing on remediation where advice-related failures have led to poor customer outcomes, and the results of this review will feed into that work," he said.

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