



Ontrack 

Monthly recap of global and domestic news

June 2018

What's made news recently?

- › Governance and legislation update
 - ◆ Royal Commission fallout intensifies
 - ◆ APRA report into CBA “damning”
 - ◆ Government accepts Senate white-collar crime report recommendations
 - ◆ AFCA appoints board members
 - ◆ SMSF member maximum increased
- › Economic and central bank update
 - ◆ RBA outlook too “optimistic”
 - ◆ 2018/19 Budget: minor adjustments rather than sweeping reforms
- › Industry update
 - ◆ New alliance for retirement formed
 - ◆ ASFA updates retirement budget.

Knowledge areas and accreditation

Knowledge area: Credit and Mortgage Broking (45 minutes/0.75 points). AFA CPD points: 0.75 (AFA 01022009). CPA Australia CPD points: 0.75 (CPA 000563). FBAA CPD points: 0.75. TPB CPE (45 minutes/0.75 points).



Learning objectives

After reading this article, you should be able to:

- › discuss current issues in the financial services industry
- › explain APRA's view on governance, culture and accountability
- › discuss implications of the Federal Budget
- › examine changes to SMSFs.

Governance and legislation update

Royal Commission fallout intensifies

Fallout in the financial services sector has intensified following the second round of public hearing at the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

AMP came out swinging in its response to the Royal Commission, arguing that fees for no service was old news and its misleading representation to ASIC were overstated.

However, investors were unimpressed by AMP's historical conduct and response to the revelations. When proxy votes became known two days before the annual general meeting on 10 May 2018, three board members were forced to resign. Vanessa Wallace and Holly Kramer, who were up for re-election, exited before the AGM. Patty Akopiantz, the longest-serving director but who was not up for re-election, will leave by the end of 2018. These resignations follow the departure of CEO Craig Meller, chair Catherine Brenner, and in-house counsel Brian Salter.

This was not enough to stop the largest shareholder protest vote in Australian major corporate history. More than 61% of votes were against the company's remuneration report. A second strike of more than 25% next year would force all the board out.

Australian Ethical — which has more than \$2.6 billion in funds under management across superannuation and managed funds — divested from AMP following the AGM.

In a statement, Australian Ethical head of ethics research Dr Stuart Palmer said:

The information released by AMP since the conclusion of the most recent Royal Commission hearings, including at its AGM today, doesn't give Australian Ethical reason to change ... [our] assessment of the evidence presented to the Royal Commission ... Australian Ethical has decided AMP's actions are in breach of its ethical standards and therefore decided to divest.

AMP is also fighting class actions by shareholders, who have seen the value of their shares plummet. Shares have fallen by about 25% since the beginning of the second hearing, wiping out more than \$2 billion from the company's value. AMP said it would "vigorously" defend against the claims.

In attempt to contain the unfolding crisis, AMP has appointed David Murray as chair of the board. He is the former CEO of Commonwealth Bank and was the chair of the highly influential Financial System Inquiry.

While numerous commentators expect Commissioner Kenneth Hayne to recommend an end to the vertically integrated model, market forces appear to be achieving that result already.

ANZ announced it will cease paying bonuses to financial advisers for selling products. It has also exited from most its wealth advisory and insurance business.

Following suit, NAB is exiting wealth management with the sale of MLC. CBA has undertaken a study to float Colonial First State Asset Management.

NAB chief executive Andrew Thorburn commented that the sale of MLC has long been in the works and the timing was not a result of the Royal Commission.

"It really has had nothing to do with what has come out in the Royal Commission ... it's been a very considered and deep piece of work," he said.

"We would not make a decision that's this major based on a couple of weeks of evidence at the Royal Commission — respecting the Royal Commission's importance."

ASIC has also been the target of public and political ire following the second hearing, seen by some, such as former Prime Minister Tony Abbot, as an ineffectual watchdog for choosing to use enforceable undertakings against large financial institutions as opposed to taking them to court. The Federal Government (Government) has promised ASIC a further \$10.6 million to help it deal with the costs of appearing at the Royal Commission.

The Royal Commission's interim report is due no later than 30 September, though Federal Treasurer Scott Morrison has stated he is willing to give Commissioner Kenneth Haynes more time should he want it.

APRA report into CBA "damning"

APRA's *Prudential Inquiry into the Commonwealth Bank of Australia (CBA) Final Report* into CBA's governance, culture and accountability was described as "damning" by Federal Treasurer Scott Morrison.

The report concluded that the bank's financial success had made it complacent, reactive to risks, insular, added it did not learn from past mistakes and that an overly collegial environment curtailed constructive criticism, timely decision-making and a focus on outcomes.

"The report, I think, is required reading not only for every financial institution in this country, but, frankly, it should be the next item on the agenda of every single board meeting in this country, regardless of whether you're a bank or not. It goes to the heart of what responsibilities of board directors are ... This should be a wake-up call for every board member in the country, particularly those who are the custodians of the savings and shareholdings of millions of Australians," Morrison said.

APRA chair Wayne Byres said given the nature of the issues identified in the report, all regulated financial institutions will benefit from conducting a self-assessment to gauge whether similar issues might exist in their institutions.

Issues the report identified included:

- › inadequate oversight and challenge by the board and its committees of emerging non-financial risks
- › unclear accountabilities, starting with a lack of ownership of key risks at the executive committee level
- › weaknesses in how issues, incidents and risks were identified and escalated through the institution and a lack of urgency in their subsequent management and resolution
- › overly complex and bureaucratic decision-making processes that favoured collaboration over timely and effective outcomes and slowed the detection of risk failings
- › an operational risk management framework that worked better on paper than in practice, supported by an immature and under-resourced compliance function
- › a remuneration framework that, at least until the AUSTRAC action, had little sting for senior managers and above when poor risk or customer outcomes materialised (and, until recently, provided incentives to staff that did not necessarily produce good customer outcomes).

The report included numerous recommendations for addressing these issues within CBA, focusing on five key levers:

- › more rigorous board- and executive-committee-level governance of non-financial risks
- › exacting accountability standards reinforced by remuneration practices
- › a substantial upgrading of the authority and capability of the operational risk management and compliance functions
- › injection into CBA's DNA of the 'should we' question in relation to all dealings with and decisions on customers
- › cultural change that moves the dial from reactive and complacent to empowered, challenging and striving for best practice in risk identification and remediation.

The report was launched because of a number of incidents that damaged the bank's reputation and public standing.

CBA's accountability failures have cost the bank's bottom line. Most recently, on 9 May 2018, CBA announced an in-principle agreement with ASIC to settle legal proceedings in relation to the rigging of the Bank Bill Swap Rate. Assuming Federal Court approval, the settlement will cost CBA \$25 million.



Did you know?

The BBSW

The BBSW is a short-term interest rate used to price derivatives and securities. Similar to the London Interbank Offered Rate (LIBOR), the BBSW is used as an interbank borrowing rate.

CBA will acknowledge that it attempted to engage in unconscionable conduct in breach of the *Australian Securities and Investments Commission Act 2001* in the course of trading on the BBSW market in Australia on five occasions between February and June 2012.

In February, CBA disputed the proceedings stating that it did not “believe our employees have engaged in unlawful conduct, nor have they done anything that would have adversely impacted the efficiency and integrity of financial markets as alleged, or at all”.

It will now concede that it did not have adequate policies and systems in place to monitor the trading and communications of its staff in order to prevent unconscionable conduct from occurring.

Adding to CBA chief executive Matt Comyn's difficulties is the departure of another executive – chief financial officer Rob Jesudason. Six executives have left since AUSTRAC filed proceedings against the bank in August 2017 for breaches to the *Anti-money laundering and Counter-terrorism Financing Act 2006*.

Since taking the helm on 9 April, Comyn has had to deal with a Royal Commission, the “damning” APRA report and now heads into the end of financial year without a permanent CFO.

Government accepts Senate white-collar crime report recommendations

The Turnbull Government has accepted the majority of the recommendations from the Senate Economics References *Committee Lifting the fear and suppressing the greed: Penalties for white-collar crime and corporate and financial misconduct in Australia* report.

Specifically, the Government has agreed to increase the availability of infringement notices, to increase civil penalties and allow the maximum civil penalty to be set by a multiple of benefit gained or loss avoided, and to allow for disgorgement of profits in civil proceedings.

The Senate Inquiry into Penalties for White Collar Crime was established in 2015 to address inconsistencies and inadequacies of current criminal, civil and administrative penalties for corporate and financial misconduct. The Senate Committee reported on 23 March 2017.

However, the Government did not accept the recommendation to “provide greater clarity regarding the evidentiary standards and rules of procedure that apply in civil penalty proceedings involving white-collar offences”.

The ASIC Enforcement Review Taskforce made similar, though not identical, recommendations in its report, submitted in December 2017. The Government agreed to all the Taskforces recommendation, but deferred implementation of certain suggestions to allow the Royal Commission findings to be taken into account.

AFCA appoints board members

Four more board members are to be appointed to the Australian Financial Complaints Authority (AFCA). This follows the appointment of former Federal Senator Helen Coonan as independent chair on 4 May 2018.

The board will consist of five industry and five industry directors, with the independent chair bringing the board to a total of 11 people.

The Bill to establish the new one-stop shop for financial complaints was passed in February 2018. The new body will start hearing complaints no later than 1 November 2018. It will replace three existing bodies – the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal (SCT).

“I am confident that each board member will make a valuable contribution to guide the new authority to ensure it delivers on its important mandate,” Minister for Revenue and Financial Services Kelly O’Dwyer said.

The four board members to be appointed are:

- › Claire Mackay — a “highly regarded financial planner,” according to O’Dwyer. Mackay will be appointed as an industry director. She will bring the perspective of small financial firms to the AFCA Board.
- › Andrew Fairley — an equity lawyer with over 35 years’ specialist experience in superannuation. Fairley will be appointed as an industry director. He will bring the perspective of the superannuation industry to the AFCA Board.
- › Erin Turner — an experienced consumer advocate. Turner will be appointed as a consumer director. She will bring the perspective of consumers of financial services to the AFCA Board.
- › Alan Wein — a lawyer, mediator and experienced advocate for small- and medium-sized businesses. Wein will be appointed as a consumer director. He will bring to the AFCA board an understanding of the experiences of small businesses in dispute with financial services businesses.

Three industry and three consumer directors are still to be appointed.

SMSF member maximum increased

The number of members an SMSF can have will be increased from four to six, and rolling funds into the vehicle will be made easier, in upcoming changes from the Government.

Minister for Revenue and Financial Services Kelly O'Dwyer said the "change will allow for greater flexibility and, given the growth in the sector to date, [and] will ensure SMSFs remain compelling retirement savings vehicles into the future,"

SuperStream will also be extended to include SMSF rollovers, allowing SMSF members to initiate and receive rollovers electronically between an APRA fund and their SMSF.

O'Dwyer has asked the ATO to work with industry to design and implement the reform, which is expected to commence from 1 July 2019.

The move is expected to help larger families. Currently, families that have more than four members (for instance, two parents and three children) cannot all be in the same SMSF. It is hoped that more members will help with intergenerational solutions, such as improving the SMSF's cash flow from younger members' contributions as older members retire.

However, the addition of extra members will alter the trust arrangements. This carries complexity and risk. For instance, the children in the SMSF may decide to outvote their parents to change to an aggressive investment strategy that is ill-suited for retirement.

Economic update

RBA outlook "too optimistic"

The RBA's outlook on growth is too optimistic, according to AMP chief economist Shane Oliver.

In its 2 May 2018 statement, the RBA said it expected growth to average slightly above 3% in 2018 and 2019.

However, while Oliver agreed a number of factors will keep the economy growing, such as booming infrastructure investment, he expected other factors will dampen the increase, specifically, "housing construction is slowing and consumer spending is constrained with downside risks around slow wages growth, high debt levels and falling house prices in Sydney and Melbourne".

"So while growth will likely improve from the 2.4% pace seen last year, it is likely to be to between 2.5% and 3%, below RBA expectations for a pick up to 3.25%," Oliver said in a statement.

Additionally, low wages growth and low inflation, tightening lending restrictions, and more weakness in the housing market will all contribute to the RBA continuing to hold interest rates until 2020, Oliver predicted.

The Australian central bank has not changed interest rates for 19 months, with the rate still at 1.5%. An increase has been even longer in coming; the last raise occurred on 3 November 2010.

2018/19 Budget: minor adjustments rather than sweeping reforms

The 2018/19 Federal Budget was generally welcomed by economists, as it contained a small boost to households and keeps the budget on track for a surplus. According to AMP chief economist Shane Oliver the main risk is that the revenue boost seen this year is not sustained and the budget continues to have relatively optimistic assumptions regarding revenue growth.

“The 2018-19 Budget will be the last before the next election (due by May 2019) and so had to provide pre-election goodies but in a way that keeps the return to surplus on track,” he said.

“Thanks to an improvement in the budget position since the Mid-Year Review, of around \$7bn per annum, this has been made relatively easy. A modest fiscal stimulus will help households, but the main risk is that the revenue boost proves temporary.”

Oliver’s key Budget measures

- › Income tax cuts from July for low to middle income earners of up to \$10 a week, which is mainly achieved by lifting the Low Income Tax Offset and raising the \$87,000 tax threshold to \$90,000.
- › A plan for broader tax cuts commencing in 2022, which from 2024 includes removing the 37% tax bracket and having the 32.5% tax bracket go all the way up to \$200,000.
- › Dropping the planned 0.5% Medicare levy increase.
- › Ongoing commitment to cut the corporate tax rate to 25% for large companies by 2026/27.
- › Extension of the small business instant asset write-off.
- › Increased spending on home aged care, various concessions for older Australians related to superannuation contributions and work tests, more hospital funding and new products listed on the Pharmaceutical Benefits Scheme.
- › An extra \$25bn in infrastructure spending including the Melbourne rail link, Queensland’s Bruce Highway, Gold Coast and Brisbane M1, road and rail in Western Australia and North-South Corridor in South Australia.

Greater flexibility

The FPA welcomed measures to simplify income tax and introduce greater flexibility into the superannuation system.

FPA CEO Dante De Gori said that offering relief from household budget pressures would allow families to imagine a future in which their financial goals are met, and may even open the door to investment.

“Introducing a Low and Middle Income Tax Offset ranging from up to \$530 for an individual and up to \$1,060 per family, offers household budget relief in a lump sum following a tax assessment. Individuals will have the choice of where to direct this windfall, be it paying critical bills or investing for the future,” he said.

“Financial planners would likely encourage clients to accelerate debt repayments, invest this tax saving to meet financial goals or as an additional contribution to superannuation. The reality of low wage inflation over recent years has prompted the Government to act in a manner that returns disposable income to people’s pockets.”

Industry update

New retirement alliance formed

Six associations have banded together to form the Alliance for a Fairer Retirement System, in response to Labor’s proposed changes to franking credits.

The alliance’s self-described aim is to “explore options to fix problems with the existing superannuation taxation, Age Pension means testing and broader retirement income systems”.

The six associations are the: Australian Shareholders’ Association, Australian Listed Investment Companies Association, National Seniors Australia, SMSF Association, Self-managed Independent Superannuation Funds Association, and Stockbrokers and Financial Advisers Association.

The impetus for the alliance’s creation was Labor’s proposal to disallow refunds of excess franking credits for a range of retirees and shareholders.

“We need more evidence-based research and policy development and increased bipartisan support to complete the development of Australia’s retirement income system. Once that development has been completed, there needs to be a period of ongoing stability for the system so that Australians can plan for their retirement with confidence,” Alliance spokesperson Deborah Ralston said.

The Alliance is considering a report by Rice Warner on the implications on changing franking credits. It is also considering commissioning and encouraging further research into retirement policy.

It has also invited other associations to join the alliance.

ASFA updates retirement budget

ASFA’s retirement standard at the modest level has increased for both couples and single people.

For the March 2018 quarter, couples aged 65 living a modest retirement need \$39,353 per year and single people need \$27,368. This is up from the September 2017 quarter (the most recently reported quarter) at \$35,189 and \$24,506 respectively.

The increase reflects price increases, more detailed pricing of items and changes in the package of goods and services in the budgets.

“Along with updating budget items for price increases and providing more detailed information on items such as water charges, other significant changes have been made in the budgets to reflect new products and services. These include subscriptions to digital streaming of music and movies and television programs. The budgets also make allowance for broadband internet connection with substantial downloads,” ASFA chief executive Martin Fahy said.

The change was less pronounced for those aged around 65 living a comfortable retirement; couples would need \$60,264 per year and singles \$42,764 at the March 2018 level.

Table 1: Budgets for various households and living standards for those aged around 65 (March quarter 2018, national)

Household type	Single Modest	Single Comfortable	Couple Modest	Couple Comfortable
Food	\$89.00	\$115.10	\$165.00	\$200.00
Clothing and footwear	\$20.10	\$26.90	\$38.20	\$50.00
Housing	\$97.40	\$114.00	\$109.50	\$119.20
Energy	\$37.80	\$47.90	\$50.80	\$59.40
Household goods and services	\$33.70	\$73.10	\$39.40	\$89.85
Health	\$47.35	\$97.20	\$91.20	\$181.70
Transport	\$87.00	\$142.00	\$93.00	\$154.10
Recreation	\$92.20	\$178.50	\$144.70	\$268.10
Communication	\$19.80	\$24.70	\$22.30	\$32.15
Total per week	\$524.30	\$819.20	\$753.90	\$1,154.5
Total per year	\$27,368	\$42,764	\$43,695	\$60,264

The figures in each case assume that the retiree/s own their own home and relate to expenditure by the household. This can be greater than household income after income tax where there is a drawdown on capital over the period of retirement. All calculations are weekly, unless otherwise stated.

Source: ASFA.

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