

PFA Conference 2018

Regulatory Update

Adelaide
29 April 2018

Introduction

RG97
Update

CCIV
Update

ASIC Fee
for Service
Update

Royal
Commission
Update

ASIC's
expanding
powers
Update

RG97 Update

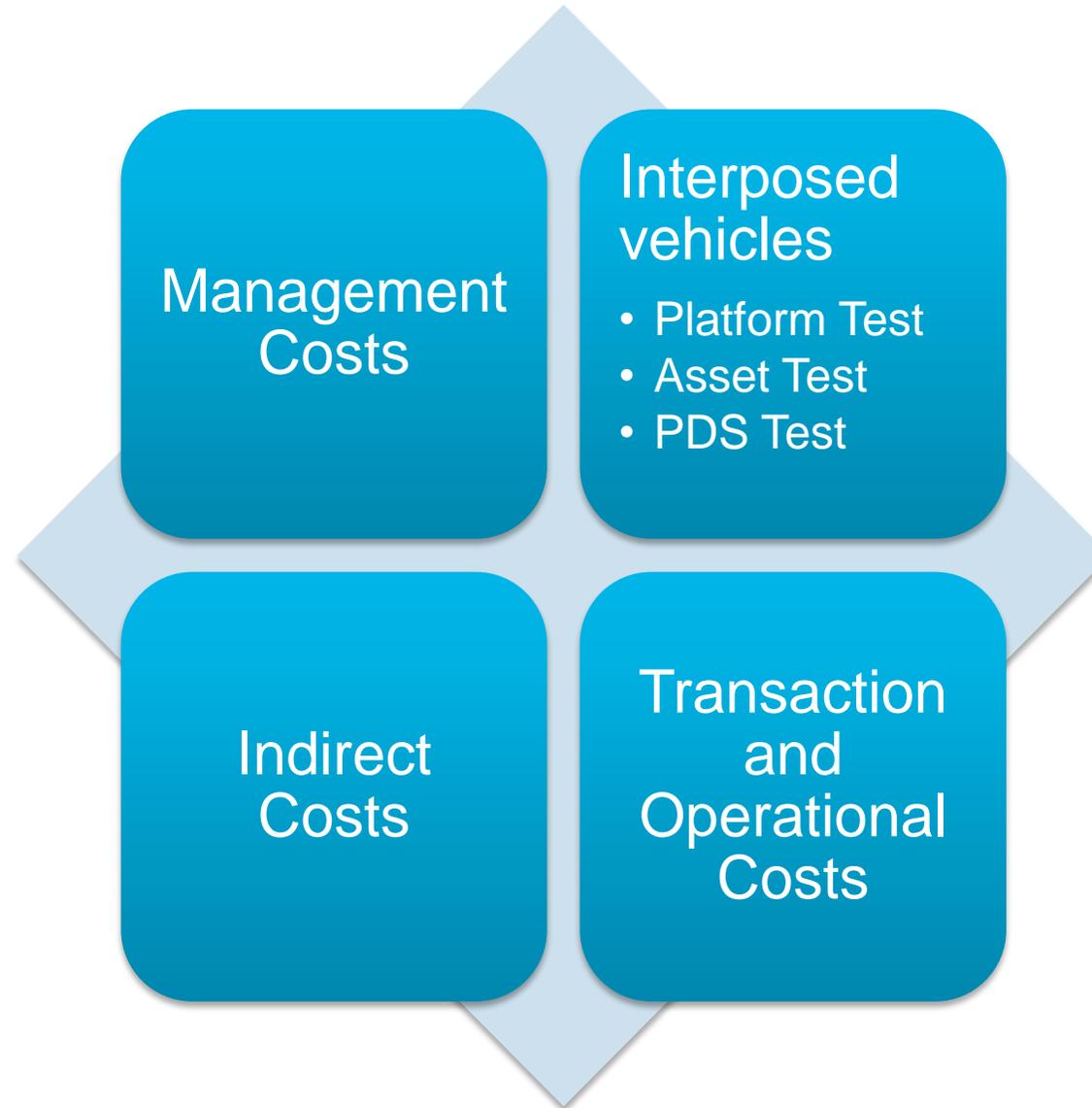
Purpose of RG97

Applied to industry from 1 March or 30 September 2017
(CO 14/1252 amended 4 times from December 2015)

- To promote transparency and comparability
- To address inconsistencies in existing regime
- To remove 'fee gaming'

=> Query whether objectives are being achieved?

Key concepts



Current State of Play

ASIC announces appointment of expert to review RG97 compliance (28/11/18) to consider:

- the value of fee and cost information for consumer decision making and the extent to which it assists consumers (including by contributing to market analysis) in comparing products; and
- the practicalities and costs of producing fee and cost information.

Industry consultation phase (including PFA) identified 13 issues, including:

- Property Operating Costs
- Borrowing Costs
- Performance Fees
- Borrower Fees (mortgage funds)

Extension of facilitative approach during review period – no action if use reasonable endeavours to comply

Final report expected by 30 June

CCIV Update

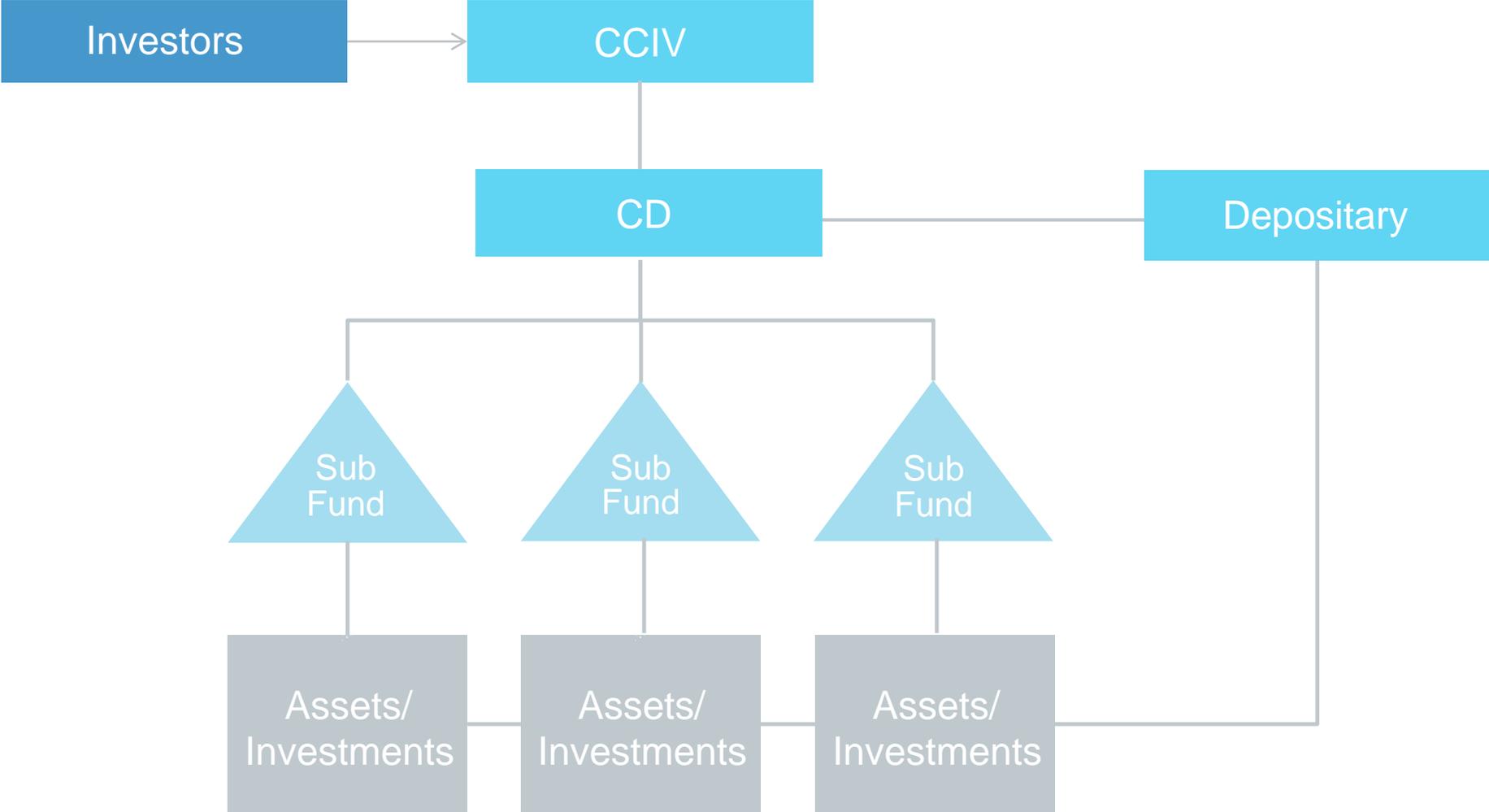
CCIV - Background

- Draft Bill released 25 August 2017 the Federal Government released the draft *Treasury Laws Amendment (Corporate Collective Investment Vehicle) Bill 2017*
- Submissions closed on 25 September 2017
- Treasury consulted with industry in round tables and received various submissions
- Implementation of recommendations from the Australian Financial Centre Forum's Australia as a Financial Centre: Building on our Strengths report from November 2009, creating a corporate fund structure similar to those popular throughout Europe and Asia
- Modelled on the UK's open-ended investment company legislation
- Hybrid structure combining regulatory regimes of a managed investment scheme and a company with share capital
- Further draft legislation expected soon – consultation still going on

CCIV – ASIC CP296

- Draft Regulatory Guide 000 *Funds management: Establishing and registering a fund*
- Draft updated Regulatory Guide 134 *Funds management: Constitutions*
- Draft updated Regulatory Guide 132 *Funds management: Compliance and oversight*
- Draft updated Regulatory Guide 133 *Funds management and custodial services: Holding assets*
- Draft updated Regulatory Guide 136 *Funds management: Discretionary powers and*
- [Draft Regulatory Guide 000 Foreign passport funds]

CCIV - Diagram



CCIV – Key Features

- Company limited by shares with a corporate director (CD) (no individual directors or employees)
- CD must be a public co. that holds an AFSL authorising it to operate a CCIV
- CD will have its own board of directors - a majority of the directors are required to be external directors
- Retail and wholesale CCIVs
- Must have at least one sub-fund at all times
- Open ended or closed ended
- Must have constitution, retail CCIVs have prescribed content similar to a MIS
- Retail CCIV must have a compliance plan
- Retail CCIV must have a depositary (optional for wholesale CCIVs). Depositary holds the assets of the CCIV on trust for the CCIV and also has oversight role

Sub-funds

- Must have at least 1 sub fund at all times
- Sub-fund don't have a separate legal personality, the assets of liabilities of the CCIV must be allocated to a sub-fund of the CCIV
- Assets of a sub-fund must not be used to meet the liabilities or expenses of other sub-funds
- Segregation is intended to protect investors in a sub-fund from investment results of other sub-funds
- A sub-fund can have different classes. Several classes of shares may be referable to the same sub-fund although every share in a CCIV must be referable to only one sub-fund. A holder of a share in a particular sub-fund will be a member of that particular sub-fund as well as a member of the CCIV
- New sub-funds notified to ASIC beforehand

Wholesale CCIV and MIS compared

- CD AFSL holder to be a public company cf MIS can be either public or private
- Majority of directors of CD required to be external cf MIS no such requirement
- Wholesale CCIV required to be registered cf MIS not required to be registered
- Wholesale CCIV must lodge constitution with ASIC cf MIS not required to do so
- Problematic definition of what constitutes a retail CCIV:
 - can be read so that 1 retail investor makes it retail
 - No 20/12 /\$2 million exception
 - If CD has one retail CCIV all CCIVs it is CD for are deemed retail

Depository

- Mandatory for retail CCIV optional for wholesale CCIV
- If wholesale CCIV has depository, must comply with all depository requirements
- Similarly required under the UCITS regime which is well understood and a popular investment vehicle in the Asian region
- Depository cannot be removed by the CD and can only be replaced by a special resolution at a general meeting
- Depository is required to satisfy statutory independence tests
- Oversight responsibilities

Depository - independence

- A Depository is required to satisfy all of the following three statutory independence tests:
 - Conflict of interest test is not met if a director or officer of the CD of the CCIV, or any associate of a director of the CD:
 - is a director, officer or employee of the depository
 - is in a position to control more than 0.5% of the maximum number of votes that could be cast at a general meeting of the depository
 - has any other relationship with the depository which might reasonably be expected to give rise to a potential conflict of interest
- 20% voting power test is not met if:
 - the CD's voting power in the depository exceeds 20%; or
 - the depository's voting power in the CCIV, CD or a class or classes of shares in the CD exceeds 20%.
- Control test is not met if the depository controls the CD

Depository - oversight

- Supervisory responsibility to take reasonable care to ensure that the CD's activities comply with the Corporations Act, the constitution and any PDS issued by the CCIV in relation to:
 - issuing, redeeming and cancelling shares in the CCIV
 - valuing shares in the CCIV
 - allocating assets and liabilities to sub-funds of the CCIV
 - allocating and distributing income of the CCIV
- Depository to ensure the CD's instructions and conducts are lawful and compliant with the constitution and PDS
- Required to report breach that have, or likely to have, a material adverse effect on interests of members as soon as reasonably practical

Potential changes in draft bill

Private company CD for wholesale CCIV

Supervisory obligations of depository to be reduced

Maybe option of compliance committee, if so maybe no requirement for majority external directors of CD

Allow for compulsory redemptions

Retail/wholesale distinction more in line with MIS

Latest ASIC Discussions

Main discussion points:

- Independence of the depositary from the corporate director and whether structural separation should be set out in legislation
- Listing of sub-funds – ASX's views, practicality, whether LICs can be converted to subfund to gain flow through tax status
- Whether a sub-fund can drop in and out of being a wholesale or retail subfund given the tests
- Conversion process from wholesale to retail subfund and vice versa
- Whether CCIVs should be either entirely wholesale or entirely retail or both permitted
- Whether the whole regime is just unmarketable and will be ignored because of cost and other structural issues

Treasury will give further thought on:

- Whether depositary independence should be principles based or set in legislation
- Whether policy settings require custody and administration functions to be segregated
- Insolvency issues of subfunds
- Revised drafting will come in chunks

Industry Funding Model

Industry Funding Model

- FSI recommendation – consultation process since August 2015.
- User pays/cost recovery model:
 - annual levies; and
 - fees for services.

Process Key/Dates

January 2018

ASIC publishes final CRIS for 2017-18

March 2018

ASIC releases indicative levies for 2017-18

June 2018

ASIC publishes forecast cost data and indicative levies for 2018-19

July – September 2018

Lodge 2017-18 Annual Returns

October 2018

ASIC Annual Report and CRIS

January 2019

ASIC sends invoices

Industry Funding Model (cont.)

Examples of levies:

• Credit providers	\$2,000 (up to \$100M)
• Credit Intermediaries	\$1,000 (no. of reps)
• Responsible Entities	\$7,000 (up to \$10M)
• Wholesale trustee from 1/7/18)	\$7,000 (graduated

Examples of proposed fees:

• Permission to act as debenture trustee	\$16,030
• Application for registration of MIS	\$3,029
• Notifications re change of RE	\$1,187
• PDS lodgement	\$1,193

Industry Funding Model (cont.)

ACL

- | | |
|-----------------------|-------------------|
| • credit provider | \$3,468 - \$4,624 |
| • non-credit provider | \$1,798 - \$2055 |

AFSL application (electronic)

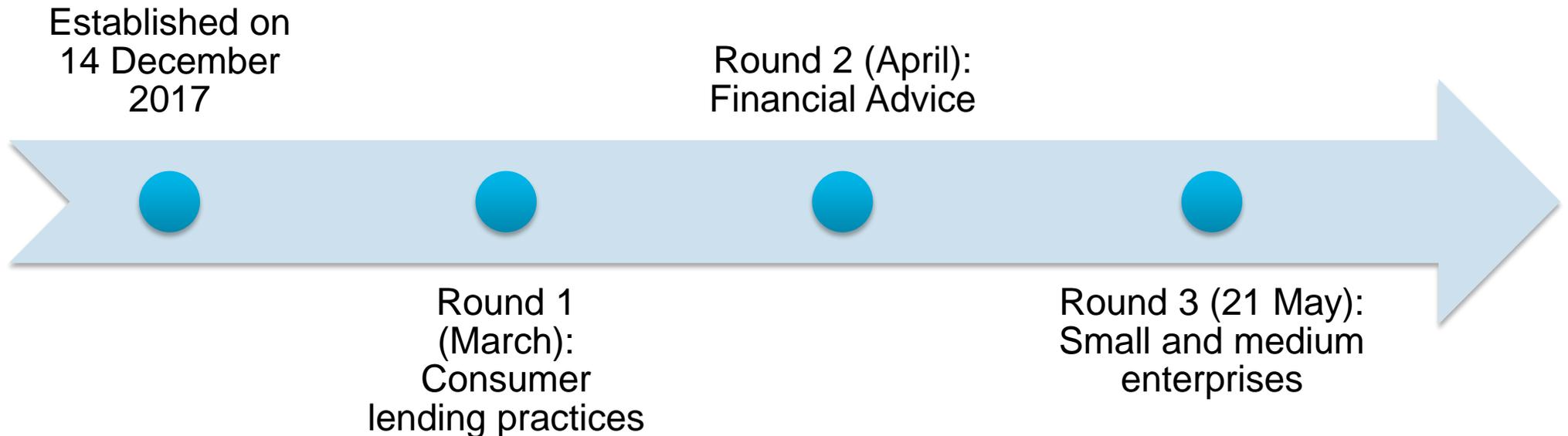
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|-----------------------|-----------------|
| • Retail | \$2,233–\$7,537 |
| • Wholesale | \$1,488–\$5,025 |
| • Relief applications | \$3,487 |

Royal Commission Update

Timeline

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

- 3822 Submissions (Banking 67%; Superannuation 9%; Financial advice 8%)
- Exploration of misconduct falling below 'community standards'



Royal Commission

Reporting to ASIC

- Institutions in trouble for significant delay in reporting breaches.
- AMP made false and misleading statements to the regulator.

Systems control

- The major banks did not have adequate systems in place to detect wrongdoing.
- Westpac's audits were not conducted with enough regularity for the system to work. Paraplanning services were insufficient to control mistakes.
- CBA had no systems at all to determine whether services were being provided.
- ANZ continued using systems it acknowledged were ineffective in achieving objectives.

Royal Commission

Real consequences for failure and positive reinforcement

- Westpac conducted annual audits, but demerit points accrued would drop off after six months.
- The case study of Mr. Smith showed that an individual could fail three out of four audits and receive no negative consequences.
- Westpac's system had no 'merits' for performing well, only demerits for performing badly.

Closer scrutiny of bad actors

- ANZ on-boarded advisers who had failed competency tests and then had failed to monitor them closely enough.
- Advisers constantly failing audits were not supervised closely enough to ensure that improvements were being made

Royal Commission

Timely reports to the regulator

- When any potential breach of the Corporations Act or other laws are found, the relevant regulator **must** be notified within the prescribed time.

Adequate self-monitoring systems

- Funds should have sufficient systems in place to monitor for potential issues early.
- This can range from automatic detection to conducting sufficiently regular audits to cover all aspects of the business

Royal Commission

Real consequences for mistakes

- Any systems for discipline need to have real consequences. It should not be possible to fail three out of four audits with no real consequence for individuals involved.

Positive reinforcement

- Consequences should not only be negative. Good behaviour of employees should be rewarded.

Control systems need to work

- Having reward and punishment systems in place that actually fulfil objectives.
- Ensuring that any system being used to improve performance actually function well – and not continuing to use systems acknowledged to be ineffective.

Royal Commission

Grandfathering

- Counsel Assisting was also keen to establish that grandfathered platforms represented a significant amount of the fees that were being collected by AMP.
- Counsel Assisting really hammered AMP on grandfathering and whether grandfathered agreements represented a potential conflict of interest for AMP, especially in circumstances where AMP could not:
 - identify any potential advantages that a customer could have operating on that platform.
 - speak to whether there was any plan at all to transition the customers out of grandfathered platforms except via attrition.
 - explain why it had not activated in-specie transfers between platforms to allow those on grandfathered platforms to transfer out of the platform without triggering a CGT event.

Vertical integration

- There was lots of questioning around the vertical integration model and incentives.
- In questioning NAB, Counsel Assisting was asking whether NAB was considering divesting from their financial planning businesses.
- Bonuses were provided on a basis of Westpac products sold.
- Questions were also raised in ANZ testimony about why 15% of the KPI for planners remain as their financial performance in relation to revenue raised for ANZ products. Line of questioning suggested that basing bonuses on this particular metric was a clear indicator of potential conflicts of interest.

Royal Commission

Independent Reports

- Care must be taken in dealing with 'independent reports'
- Internal v external v independent
- Factual amendments v substantive amendments



Amending the wording of an 'independent' report to reduce the impact of that report is completely unacceptable

ASIC's Expanding Powers

ASIC Enforcement Review

Taskforce established in October 2016

8 papers have been released:

- **‘Self-reporting of contraventions by financial services and credit licensees’ (11 April 2017)**
- ‘Harmonisation and Enhancement of Search Warrant Powers’ (28 June 2017)
- **‘Strengthening ASIC’s Licensing Powers’ (28 June 2017)**
- ‘Industry codes in the financial sector’ (28 June 2017)
- ‘ASIC’s Access to Telecommunications Intercept Material’ (20 July 2017)
- **‘ASIC’s power to ban senior officials in the financial sector’ (6 September 2017)**
- **‘Strengthening Penalties for Corporate and Financial Sector Misconduct’ (October 2017)**
- **‘ASIC’s Direction Powers’ (20 November 2017)**

ASIC Enforcement Review

Reports

- Taskforce Report provided to government - December 2017
- Australian Government response to the ASIC Enforcement Review Taskforce Report – April 2018
- Agreed to all 50 recommendations from report

Headline changes:

- Breach reporting – objective test and time extended from 10 to 30 days, irrespective of investigation being finalised
- Tougher ASIC licensing powers and change of control requirements
- Increased maximum civil penalties \$525,000 (individuals) and \$10.5M - \$210M (corporations) [currently \$200k/\$1M]
- Increased maximum for serious offences: 10 years imprisonment/\$945,000 (individual) and \$9.45M + (corporations)
- Infringement notices and direction powers

Design & Distribution Obligations

***Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018.
[21 December 2017]***

- FSI Recommendations 21 & 22
- Consultation Paper December 2016
- Applies to offers that would require prospectus or PDS (except ordinary securities)
- New products and new offers of old products 12 months from commencement date

Design & Distribution Obligations (cont.)

Design Obligations

- Issuer must make a ‘target market determination’:
 - Describe the class of persons who comprise the target market for the product; and
 - set out any conditions and restrictions on dealings in, or providing financial product advice in relation to, the product (other than under the Act) (e.g. customer must receive personal advice or/and particular distribution channels)
- TMD must be ‘appropriate’ – it would be reasonable to conclude that if the product was issued or sold to target market, in accordance with the distribution conditions, the product would generally meet the likely objectives, financial situation and needs of the person in the target market
- Must review the target market determination to ensure it remains appropriate, keep records and notify ASIC of any dealings that are not consistent with the determination
- If TMD no longer appropriate must give direction to regulated persons who deal or advise on the product

Design & Distribution Obligations

Distribution Obligations

- Not to deal or provide advice on financial product unless TMD has been made
- Not to deal or provide advice when a TMD is no longer appropriate
- To take reasonable steps to ensure that products are distributed in accordance with TMD
- To collect information related to the distribution of a product
- To notify issuer of significant dealings not consistent with the TMD

ASIC stop order powers

Civil and Criminal penalties:

- Civil: \$200,000 (individual); \$1 million (corporate)
- Criminal: 200 penalty points; 5 years imprisonment (generally)

ASIC Intervention Powers

ASIC Intervention Powers

- Applies to issue of retail products and consumer credit products
- ASIC may make 'intervention order' for up to 18 months where it is satisfied that a product or class of products has resulted, or is likely to result, in 'significant detriment' to retail clients
- '**Significant detriment**' = take account of the nature and extent of detriment, actual or potential financial loss and impact on retail clients
- Orders can prohibit specified conduct in relation to product outright, or impose conditions. Includes banning the issue of products, or limiting issue to certain class, or requiring warnings or labels
- Consultation with 'affected parties' and public notification required
- Minister may make order permanent

Other Updates

AFCA 14 September 2017

*Treasury Laws Amendment
(Putting Consumers First -
Establishment of the
Australian Financial
Complaints Authority) Bill
2017*

New external dispute
resolution framework

Single dispute resolution
scheme for all disputes
concerning products and
services provided by
financial firms

AFCA will replace
Superannuation Complaints
Tribunal (SCT), FOS and
COSL

Questions



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Thank you