

The Government's response to the Financial System Inquiry recommendations

The Federal Government has released its much-anticipated response to the recommendations of the Financial System Inquiry (FSI) made in December 2014.

In its response, the Government accepts the majority of the FSI recommendations and outlines its agenda for implementing the recommendations in stages over the coming years.

The notable exception is the Government's rejection of the proposal to prohibit limited recourse borrowing by superannuation funds, stating that it 'does not consider the data sufficient to justify significant policy intervention'.

The Government's response is based on the following broad agenda items:

- strengthen the resilience of the financial system:** the resilience measures aim to reduce the impact of potential future financial crises by ensuring we are better able to weather them and lessen their cost to taxpayers and the economy.
- improve the efficiency of the superannuation system:** the superannuation and retirement incomes measures aim to improve the efficiency and operation of the superannuation system and in doing so boost retirement incomes.
- stimulate innovation in the financial system:** the innovation measures will unlock new sources of finance for the wider economy and support competition.
- support consumers of financial products being treated fairly:** the consumer outcomes measures are designed to give consumers confidence to participate in the financial system and the confidence that they are being treated fairly.
- strengthen regulator capabilities and accountability:** the regulatory system measures aim to make regulators more accountable for their performance, more capable and more effective.

Measure	Action	Hall & Wilcox commentary
Resilience	<p>By end-2015: Develop legislation to facilitate participation of Australian entities in international derivative markets and better protect client monies.</p> <p>By mid-2016: Consult on measures to ensure financial regulators have the tools they need to manage any future financial crisis.</p> <p>By end-2016: APRA to take additional steps to ensure our banks have unquestionably strong capital ratios.</p> <p>Beyond 2016: APRA to ensure our banks have appropriate total loss-absorbing capacity and leverage ratios in place.</p>	<p>In recognition of the fact that Australia is a 'net importer' of capital, the Government believes that Australia's financial sector regulatory framework needs to be stronger than those of comparable economies.</p> <p>For this reason, it will require banks to hold more capital and to address risk weights, leverage, loss absorbency and regulators' crisis management powers.</p> <p>APRA is already tackling a number of the recommendations and, whilst the response is not particularly exceptional, it is reassuring that the Government supports APRA, not least in setting capital standards that need to be unquestionably strong.</p>
Superannuation and retirement incomes	<p>By end-2015: Develop legislation to improve governance and transparency in superannuation. Progress the Retirement Income Streams Review.</p> <p>Task the Productivity Commission to immediately develop and release criteria to assess the efficiency and competitiveness of the superannuation system and to develop alternative models for a formal competitive process for allocating default fund members to products.</p>	<p>The retirement income streams review should focus on reducing the complexity in superannuation and tax law that prevents trustees from bringing new annuity-style products to market.</p> <p>The commitment to reviewing the modern award system could open up new opportunities for some funds but may erode the existing membership base of others, posing a significant threat to their ongoing viability.</p>

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	<p>By end-2016: Develop and introduce legislation to enshrine the objective of the superannuation system.</p> <p>Consult on legislation to facilitate trustees of superannuation funds providing pre-selected comprehensive income products for retirement.</p> <p>Beyond 2016: Implement legislation to introduce director penalties.</p> <p>Consult on legislation to improve member engagement, consistent with the recommendations in the Inquiry. Monitor leverage and risk within the superannuation system.</p>	<p>The proposal to ‘enshrine the objective of the superannuation system’ in legislation has been widely supported in the industry and picks up on one element of the commitment of the Gillard government to establish a Charter for superannuation that informs all Government decisions about the industry.</p> <p>The proposal to introduce director penalties seems unnecessary given the introduction of individual director covenants into the superannuation legislation in 2012 as part of the Stronger Super amendments.</p> <p>‘Member engagement’ would be greatly assisted by better rules about member disclosure, and perhaps consultation on these issues could start with an overhaul of the much criticised product disclosure regime.</p>
Innovation	<p>To date: Passed legislation to extend the period before unclaimed banking monies in the banking and insurance sector are captured from three to seven years.</p> <p>By end-2015: Consult on legislation to support crowd-sourced equity funding. Consult on crowd-sourced debt financing. Task the Productivity Commission to review access to and the use of data.</p> <p>By mid-2016: Develop legislation to ban excessive card surcharges and better protect consumers using electronic payment systems. Develop legislation to reduce disclosure requirements for issuers of ‘simple’ corporate bonds. Establish the Innovation Collaboration Committee.</p> <p>By end-2016: Give legal effect to the Asian Region Funds Passport initiative. Consider technology neutrality in financial sector regulation.</p> <p>Beyond 2016: Facilitate rationalisation of life insurance and managed investment scheme legacy products.</p>	<p>The Government has identified development of a crowd sourced equity funding market in Australia as an urgent priority so early stage innovators have a source for their funding needs.</p> <p>It will be interesting to see how the Government balances its proposal to enhance the free and efficient flow of data between entities with the restrictions under privacy legislation that relate to use and dissemination of personal information.</p> <p>The Asian Region Funds passport initiative has been in development for some time now: we hope the Government will finally be able to implement this idea as local issuers are crying out for more efficient access to offshore capital.</p> <p>The Government will consider how to best foster the growth of ‘impact’ investment to support private and for-profit investment funds being directed to projects with a social or environmental purpose.</p>
Consumer outcomes	<p>By end 2015: Develop measures to address the misalignment of incentives in life insurance.</p> <p>By mid-2016: Develop legislation which provides a professional standards framework for financial advisers. Consult on development of accountabilities for issuers and distributors of financial products and ASIC product intervention powers.</p> <p>By end 2016: Develop legislation to give ASIC the power to ban individuals from managing financial firms. Consult on strengthening ASIC’s enforcement tools in relation to the financial services and credit licensing regimes.</p>	<p>Life insurers have been anticipating change since the Trowbridge report and most are already recalibrating their distribution arrangements to reduce the amount of upfront and ongoing commissions paid to advisers.</p> <p>Product issuers will be concerned about ASIC having ‘product intervention’ powers if the release of products to market is delayed while issuers go through a review process with ASIC. It is difficult to see how this measure, as well as the others described here, could lead to more efficient operation of markets unless ASIC is also given significantly greater resources.</p>

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Regulatory system	<p>ASIC will review remuneration arrangements in the mortgage broking industry.</p> <p>Beyond 2016: Consult on and develop legislation to enable innovative disclosure for financial products and to improve the regulation of managed investment schemes. ASIC will review stockbroking remuneration arrangements.</p> <p>By end 2015: Complete a capability review of ASIC. Complete consultation on industry funding arrangements for regulatory activities undertaken by ASIC. Appoint new members and revise the Terms of Reference of the Financial Sector Advisory Council.</p> <p>By mid 2016: Update the Statement of Expectations for APRA, ASIC and the Payments System Board to provide additional guidance about the Government's expectations for their strategic direction and performance and improve regulator accountability. Consider ASIC capability review and, as appropriate, develop legislation to enhance operational capabilities of regulators.</p> <p>By end 2016: Introduce competition into ASIC's mandate.</p> <p>Beyond 2016: Commence a review of ASIC's enforcement regime. Task the Productivity Commission to review the state of competition in the financial system.</p>	<p>Having largely been spared the changes to remuneration arrangements brought about by FOFA, stockbrokers and mortgage brokers will come under the spotlight as the Government looks to crack down on other 'conflicted' practices.</p> <p>The Government is proposing to put greater focus on assessing the performance of regulators against their mandate.</p> <p>However, there is no reference to additional funding for the regulators, other than reference to consultation on the model whereby ASIC's regulatory activities would be funded by industry on a 'user pays' basis.</p> <p>A greater focus will be placed on competition in the financial system by explicitly including consideration of competition in ASIC's mandate. It will be interesting to see whether this will result in anti-competitive behaviour within the financial services industry being brought within the scope of ASIC's powers.</p>

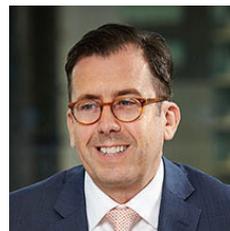
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