



INTERNATIONAL INVESTMENT FUNDS ASSOCIATION

AUSTRALIAN MEMBER REPORT

September, 2017

1. Statistical Position

1.1. General Economic and Market Data

| Table 1: Key Economic Indicators* | |
|---|-------------------------|
| Population (millions) | 24.4 (Dec 2016) |
| Annual GDP (\$ trillion) | 1.69 (2016-17) [US1.30] |
| Annual GDP growth rate: | |
| Nominal | 6.0% |
| Real | 2.9% |
| Inflation rate (%) | 1.9% |
| Unemployment rate (%) | 5.6% |
| Stock market capitalisation (\$ trillion) | 1.78 [US1.37] |
| Official Interest Rate | 1.50 |
| <i>*All figures as at 30 June 2017 and in A\$ unless otherwise stated US\$ exchanges calculated at rate of A\$1 = US\$0.7692</i> | |

1.2. Data on funds under management and portfolios

| Table 2: Net assets of the Australian Industry | | |
|--|--|---|
| Year (as at end June) | Total assets under management (US\$ billions) | Total assets under management (A\$ billions) |
| 2001 | 703.1 | 776.0 |
| 2002 | 726.6 | 802.0 |
| 2003 | 744.6 | 821.8 |
| 2004 | 892.0 | 984.6 |
| 2005 | 1041.9 | 1150.0 |
| 2006 | 1259.1 | 1389.7 |
| 2007 | 1601.1 | 1767.2 |
| 2008 | 1555.3 | 1716.7 |
| 2009 | 1418.8 | 1566.0 |
| 2010 | 1555.3 | 1716.7 |
| 2011 | 1683.8 | 1858.5 |
| 2012 | 1708.8 | 1886.1 |
| 2013 | 1928.2 | 2128.3 |
| 2014 | 2134.9 | 2356.5 |
| 2015 | 2013.8 | 2622.2 |
| 2016 | 2143.7 | 2721.6 |
| 2017 | 2285.8 | 2971.6 |

Table 3: Australian Industry Size – 30 June 2017

| <u>Asset class</u> | <u>A\$ million</u> |
|--|--------------------------|
| Equity funds | 885,833 |
| Bond funds | 125,527 |
| Money market funds | - |
| Other | 1,365,787 |
| Total (excluding Fund of Funds) | 2,377,147 |
| Total in US\$ | 1,828,501 million |

Note: *Exchange Rate as used at time of reporting (30 June 2017): A\$1 = US\$0.7692*

2. Data relating to investors in Mutual Funds / Unit Trusts

2.1 Are any data available relating to the number of investors in the mutual fund industry?

No such official data is available; however it is estimated at over 11.5 million. The majority of exposure is through superannuation (pension) investments.

2.2 If yes, please provide the data for the last two years and the source of this data.

N/A

2.3 Are there data available separately for retail investors and institutional investors?

No such data is available.

2.4 If yes, please provide data separately for retail and institutional investors for the last two years.

N/A

2.5 Does the Association play any role in promoting retail investment in the mutual fund industry? If so, please give details.

- FSC represents the industry to government, regulatory and media stakeholders;
- Members' compliance with FSC's Standards and Guidance Notes ensures the promotion of industry best practice; and
- FSC is committed to helping all investors gain financial literacy and confidence. The Consumer Information and Fact Sheet section of the FSC website provides information on investment funds, fees, superannuation (pension), insurance and much more.

3. International Investment

3.1 Are funds of other countries sold?

Yes, Australians may invest directly into foreign funds. However, foreign funds cannot be sold directly to Australian residents without first complying with Australian requirements. Australia also has a network of Mutual

Recognition Agreements, including with Hong Kong and New Zealand, which allow foreign funds to be offered under their domestic licence. Australia has also signed the Memorandum of Co-operation to participate in the Asia Region Funds Passport which will allow mutual recognition of funds from Japan, South Korea, Thailand and New Zealand. The regime is expected to commence by 31 December 2017.

3.2 Are your funds allowed to invest abroad?

Yes, there are no restrictions or limits imposed on foreign investment.

4. Legal & Regulatory developments

The Government commissioned an independent panel to undertake a holistic review of the financial services industry in 2014. The “Financial System Inquiry” reported to the Government in late 2014 and recommended a range of reforms to the superannuation system. These reforms were designed to strengthen governance arrangements, increase competition between providers and improve the retirement phase.

The Financial System Inquiry final report can be accessed at this website: <http://fsi.gov.au/publications/final-report/>

In October 2015, the Government released its response which is available here: <http://treasury.gov.au/fsi>

The Financial System Inquiry follows a superannuation specific review that was concluded in July 2010. The reforms arising from that review, the “Stronger Super” reforms, are in final stages of implementation.

Government policy and legislation can be found on this website: <http://strongersuper.treasury.gov.au/content/Content.aspx?doc=home.htm>

Legislation previously enacted to increase the compulsory Superannuation Guarantee rate for working Australians from 9 to 12% has been amended to pause the increase at 9.5% for seven years. The rate is now scheduled to increase to 12% by 2025.

The Government is currently consulting on reforms to increase the transparency of the superannuation system, and make superannuation funds more accountable to consumers. This includes enhanced reporting requirements, a requirement for fund general meetings and increased power for the prudential regulator.

Review of financial advice

The ‘Future of Financial Advice’ reforms (FOFA) represent the most significant reforms to financial advice (and the financial services industry) since the Financial Services Reform Act of 2001.

The reforms aim to improve the quality of financial advice while building consumer trust and confidence in the industry through enhanced standards which align the interests of the adviser with that of the client, and reduce conflicts of interest.

The majority of the FOFA reforms commenced on 1 July 2013.

Key elements

- Introduction of a ‘best interest duty’, which applies to the provision of personal advice to retail clients and includes a duty requiring advisers to place their clients’ interests before their own.
- Banning conflicted remuneration including commissions and certain volume based payments by platforms and product providers to advisers or holders of Australian Financial Services Licences (Licensees).
- Percentage-based fees not permitted on geared (borrowed) investment amounts.
- Expansion of ASIC’s banning powers

- Introduction of annual fee disclosure obligation imposed on clients, as well as a requirement for new clients to opt-in and renew ongoing fee arrangements every two years
- Ban on insurance commissions where the insurance policy is a group life policy for members of a superannuation fund;
- Ban on non-monetary benefits – except for education or training and IT-related benefits.

Further reforms in relation to life insurance remuneration come into effect in January 2018. The ban on conflicted remuneration will apply to life insurance – removing volume based payments from platform and product providers to advisers or licensees, and introducing upfront and ongoing commission maximums for life insurance products. Commissions on products in place before the commencement of the reforms are grandfathered.

Further, financial advisers who provide even incidental tax advice are required to be licensed by the Tax Practitioners Board under a new category of tax advice referred to as ‘tax (financial) advice’. Under the new framework, advisers will have to satisfy qualification and experience requirements specifically for tax (financial) advice purposes (these are additional to the competency requirements referred to in Part 6.5).

International Regulatory and Tax Developments

Improvements to Tax System for Managed Investment Trusts

A new tax system for Managed Investment Trusts (**AMIT**) commenced 2016. The AMIT system provides more flexibility in dealing with AMIT income and the tax treatment of AMIT investors. In 2017, the government announced a number of technical amendments to the AMIT system to ensure it meets its original policy intent.

Investment Manager Regime

The Government has implemented an Investment Manager Regime (IMR) to ensure that for non-resident investors using an independent resident investment adviser, fund manager, broker, exchange or agent:

- investments in all foreign assets would be exempt from any tax liabilities in Australia; and
- investments in Australian assets would for tax purposes be treated the same as if the investments were made directly by the non-resident without the use of any Australian intermediary.

The Government has announced a number of technical amendments to the IMR to ensure it meets its original policy intent.

Collective Investment Vehicles

Australian fund managers are currently limited to one type of collective investment vehicle (**CIV**) structure; a unit trust. The Government has committed to introduce two new CIVs from 2017 that will allow Australian fund managers to offer the sorts of collective investment vehicles that many international investors prefer and are familiar with, and to make better use of the Asia Region Funds Passport. Consultations are currently occurring on a corporate CIV and a limited partnership CIV will follow.

FSC self regulatory Industry Standards and Guidance Notes

FSC’s Standards and Guidance Notes are designed to assist members achieve industry best practice, and to enhance consumer confidence. By adhering to the Standards, FSC’s full member companies have undertaken to develop processes and products that provide investors with a quality assurance that goes beyond the base-line legislative and regulatory framework. In recognition of this, FSC is committed to the promotion of the Standards as a demonstration of integrity.

All FSC Standards and Guidance Notes can be found on the FSC website at: www.fsc.org.au.

Life Insurance Code of Practice

The FSC has been developing a Life Insurance Code of Practice (**the Code**) as part of a broad package of reforms in life insurance which have been rolling out over the past 18 months. The Code will be binding on the FSC's life insurance members from 1 July 2017. Developed through extensive public consultation with industry stakeholders, consumer groups and regulators, the Code sets strong standards of customer service for insurers and works to assist and protect consumers.

The Code goes further than the law in key consumer-focused areas of sales practices, claims, investigations and use of surveillance, medical definitions and providing additional support to vulnerable consumers. The Code will be supported by an independent governance framework, consisting of an independent committee, ensuring effective Code compliance.

Superannuation Governance

On 6 March 2012, the FSC announced a new policy entitled "Superannuation Corporate Governance Policy".

There are five key requirements of the Superannuation Governance Standard which now apply to FSC members with a superannuation fund licence:

- Majority of independent directors;
- Independent chair;
- Prohibition on multiple, competing directorships;
- Disclosure of an environmental and social governance risk management policy, and
- Proxy voting record disclosure.

This policy is reflected in Standard 20 of the FSC Standards.

Proxy Voting

The scope of the former FSC Standard No. 13 (proxy voting) was expanded in coverage in 2013 and includes all managed investment schemes and superannuation funds (in accordance with the 6 March 2012 announcement) and contains enhanced reporting requirements for operators. Standard 13 requires an operator of a scheme, in relation to **listed Australian investments**-

1. to formulate a voting policy (including proxy voting) for each Scheme it operates;
2. to disclose whether or not the operator has engaged the services of a voting or proxy consultant in exercising its voting rights, and;
3. to disclose details of the exercise of such voting rights by the Operator (on an 'entity and resolution level' basis) in respect of each financial year for each Scheme it operates;

5. Distribution of Mutual Funds

5.1 Statistic Position

N/A

6. Systems and Practices in Marketing of Funds

- 6.1 Do the Regulations specify any maximum rates for commission to intermediaries/agents/brokers? If so, please indicate.

Commissions were banned from 1 July 2013 under reforms introduced by the Government. However, the level of fees paid to intermediaries, agents and/or brokers are not capped.

6.2 What is the maximum load allowed under Regulation and for what purpose is it used?

N/A

6.3 Are there any limits prescribed for sales and marketing expenses? If so, please specify.

There is no limit for managed funds.

6.4 Is there a general or specific Regulation or Rule governing intermediaries selling mutual fund schemes? If so, which agency administers the Regulations?

The selling of mutual fund schemes comes under the *Corporations Act 2001*, which is administered by the Australian Securities and Investments Commission (ASIC). Financial advisers are required to be licensed and are regulated under Part 7.6 and 7.7 of the *Corporations Act 2001 (as amended)*.

6.5 Is there a qualifying examination for intermediaries? If so, which agency conducts the exam and what are the details such as passing marks, nature of conducting the exam, etc.

The Corporations Act has recently been amended to set down more stringent competency, education and continuing professional education requirements which will commence in January 2019. While much of the detail of the new rules is yet to be finalised, they include:

- compulsory education requirements for new and existing advisers;
- supervision requirements for new advisers;
- a code of ethics for the industry;
- an exam that will be a common benchmark for knowledge across the industry; and
- an ongoing professional development component.

The newly established Financial Adviser Standards and Ethics Authority (FASEA) will set the educational requirements, as well as develop and set the exam.

At present Licensees are obliged to ensure their advisers are adequately trained and competent to provide financial services.

ASIC's Regulatory Guide 146 sets out basic educational requirements that it considers are necessary to satisfy the competency requirements of the law.

6.6 Are there any regulations or industry rules relating to marketing practices? Can mutual funds give gifts/prizes to distributors to encourage distribution of their funds? Can such gifts/prizes be given directly to investors? Are these covered by any regulation?

Marketing material must not be misleading or deceptive.

The FOFA reforms banned advisers and Licensees from receiving non-monetary benefits unless:

- the benefit has an educational or training purpose (and even then certain conditions must be met);
- it is for information technology software and support that is relevant to providing financial product advice; and
- the benefits are below A\$300 in value, and are not given on a frequent or regular basis (where these benefits are over A\$100, they must be recorded in a register).

The Corporations Act 2001 also requires Licensees to have in place adequate arrangements for the management of conflicts of interest that may arise in relation to activities undertaken in the provision of financial services. The Act also requires a financial adviser to disclose any remuneration (including commissions) that they may receive that could be reasonably expected to influence their advice.

Superannuation funds are prohibited from offering inducements to employers.

7. Pricing Error

7.1 Are there specific rules for reporting pricing errors to the Regulator?

Both at general law and under statute, a superannuation fund trustee or the responsible entity of a managed investment scheme is required to exercise their duties efficiently, honestly and fairly. A material pricing error would be a breach of these requirements and breach-reporting obligations apply to both the Australian Securities & Investments Commission (**ASIC**) and the Australian Prudential Regulatory Authority (**APRA**).

7.2 Are there specific rules for compensating investors, in the event of pricing error?

FSC produces Standards which deal with unit pricing requirements which all members must comply with. ASIC and APRA have also issued a 'Unit Pricing: Guide to Good Practice', which is available on ASIC's website at <http://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-94-unit-pricing-guide-to-good-practice/>

7.3 Please describe how mutual fund management companies respond to pricing errors, when they actually happen.

FSC has produced Standard No.17 to be used by members when correcting pricing errors.

This Standard applies to the treatment of errors in the pricing of interests in a Scheme. In forming a policy for managing such errors, a Scheme Operator (the trustee or responsible entity) may choose to use a level of materiality to assess whether an error requires compensation to be considered for individuals in a Scheme, or the Scheme itself. For the purposes of this Standard, the materiality used for such an assessment must be no more than 0.3% of the price of a unit. Further details are contained in FSC's Standard No. 17 available on FSC's website here: <http://www.fsc.org.au/downloads/file/IFSASStandards/IFSASStandardNo17.pdf>

Where the Scheme Operator has financially benefited from an error, the Scheme Operator must pay compensation such that the Scheme Operator does not retain the financial benefit.

A Scheme Operator's processes for the assessment and compensation of errors in the pricing of scheme units must meet the following criteria:

- they must be documented and transparent;
- they must individually rectify past and present Investors that have been affected by a materially incorrect unit price;
- they must consider the obligations of Scheme Operators under relevant legislation;
- they must not result in any residual benefit to Scheme Operators; and
- they must be regularly reviewed.

Errors must be reported to the appropriate level of management within the Scheme Operator. All errors must be recorded and action taken to minimize the risk of recurrence.

When an error in unit pricing occurs and compensation is payable to past and/or present Investors, the Scheme Operator must make reasonable efforts to communicate to affected Investors and describe the nature of the error, how the error will be rectified, and how the affected Investor will be compensated for the error.

Where a Compensatable Error has been identified, compensation to or from past and/or present Investors or the Scheme will be required where the Investors or the Scheme have been disadvantaged as a result of the Compensatable Error.

Where a Non-Compensatable Event has occurred, consideration must be given to whether any further action is required to correct the pricing of the Scheme.

8. Risk Management Systems

8.1 Is there a risk management system prescribed by the Regulator? Yes/No

Australian legislation requires licenced issuers of regulated collective investment schemes to implement a risk management system.

8.2 If yes, please give a brief description.

Registered managed investment schemes (non-superannuation) are required to have a Compliance Plan that sets out the processes, systems and structures by which a Responsible Entity will continuously review how it is complying with its obligations under the legislation and the scheme constitution (section 601EB and Part 5C.4 of the *Corporations Act 2001*).

In certain circumstances, the Responsible Entity of the registered scheme may also be required to establish a Compliance Committee.

In broad terms, similar requirements around risk management systems apply to superannuation (retirement) schemes although these are framed in light of the regulation of superannuation.

If no, does the Industry Association formulate any systems? Yes/No

8.3

N/A

8.4 If yes, please give a brief description.

N/A

8.5 If no, what is the system followed in the industry?

Industry generally has regard to international standards on risk management.

8.6 Does the industry follow any system of disaster recovery /business continuity plan?

FSC's Guidance Note 23 *Major Disaster Plan* establishes a mechanism to enable consistent messages to be conveyed to member companies and consumers in times of crisis. The FSC Major Disaster Plan complements, but does not replace, FSC members' respective business continuity planning.

8.7 If yes, please give brief details.

Main features and purpose of this Guidance Note are:

- to enhance industry preparedness and assist FSC members and industry to maintain the confidence of consumers during the crucial early stages of a major disaster or an expected major disaster;
- to specify key actions for FSC, with the assistance of key decision makers in the FSC community, in the event or the likelihood of a major disaster; and
- to complement and NOT to replace FSC members' respective individual business continuity plans.

9. Performance Evaluation and Role of Performance Evaluation Agencies

9.1 Are there regulatory provisions relating to making and/or publishing performance evaluation? If so, give details.

The law prohibits misleading and deceptive conduct. Misleading performance information could be subject to action by ASIC (Australian Securities and Investments Commission).

For certain superannuation products, APRA standards prescribe the manner of performance calculation.

FSC Standard No. 6 *Product Performance – Calculation of Returns* pertains to calculation of returns. This Standard specifies principles to apply in the calculation of product performance.

FSC Standard No. 10 *Presentation of Past Performance Information and Visual Promotions* specifies standards to be adopted by an FSC member in the promotion of its Financial Products and Services; as well as provide guidance in the interpretation and application of those standards.

FSC's Guidance Note No. 1.00 *Global Investment Performance Standards* provides guidance on how performance should be evaluated and reported. This Guidance Note is not compulsory for FSC members.

9.2 Are there third research parties or other agencies doing performance evaluation? If so, give details.

A number of research houses conduct continual evaluation of the relative performance of firms in the sector, some of which is publicly available.

9.3 Are there Regulatory provisions relating to benchmark indices against which the performance of mutual fund is to be assessed?

Not specifically but use of an inappropriate benchmark (without explanation) may expose the issuer to claims of misleading and deceptive conduct.

9.4 Does the Industry Association undertake any performance evaluation activities?

No

10. Role of the Association

10.1 Does the association consist only of mutual funds or any other entities? If so, please specify.

FSC represents the retail and wholesale funds management, superannuation (pension fund), life insurance, financial advisory network, licensed trustee companies and public trustee industries.

10.2 Are there different categories of members? If so, please specify and indicate their voting rights and other obligations/responsibilities/fee structure.

FSC has two categories of Members:

- 'Full Members', being organisations actively participating in the Industry (i.e. managing collective investments) with full voting rights; and
- 'Supporting Members', being any organisations that provide professional services to the Industry, or in other ways are related to these industries.

Supporting Members have the right to attend and be heard at any general meeting of the Company, but are not:

- Entitled to vote at general meetings; nor
- Eligible for election to the Board.

The annual subscription payable by each class of members of the Company and the application fee (if any) payable by members shall be such sum as the Board may from time to time prescribe.

10.3 Briefly describe the role and functions of the Association.

FSC is a national not-for-profit organisation which represents the retail and wholesale funds management, superannuation, life insurance and financial advisory network industries. FSC has over 100 members who are responsible for investing over \$A2.7 trillion on behalf of more than 13 million Australians.

FSC's mission statement states the following objectives: "To play a significant role in the development of the social, economic and regulatory framework in which our members operate, thereby assisting members to serve their customers better."

10.4 What is the funding pattern, system of contribution?

FSC derives the majority of its revenue from membership fees and events. The formula for the calculation of each member's fees includes factors for the size of their funds under management and the industry sector they are involved in. For further explanation, please see: <http://www.FSC.org.au>

10.5 Is there any financial support provided by the Regulator/Government? If yes, please specify.

No financial support is provided by the Government or regulators.

10.6 Is the Association officially recognized as a self-regulatory organization (SRO) by the Regulator? If yes, please specify the responsibilities, role and activities.

No. FSC Standards and Guidelines are not an approved code of conduct under section 1101A of the *Corporations Act 2001*. However, FSC members are required, as a condition of FSC membership, to comply with FSC Standards. The boards of FSC member companies must complete and sign an annual statement of compliance with the Standards. Members may seek exemption from the requirements of particular standards which are considered by the FSC Standards Oversight and Disciplinary Committee (**SODC**).

The mandate of the SODC is to oversee member adherence with the principles set out in FSC Standard No.1 *Code of Ethics*. Its functions include to consider proposals for the development, revision or amendment of FSC Standards; approve new Standards or revisions to existing standards; hear and assess complaints against FSC member companies; hear and assess issues of non-compliance with FSC Standards; and, oversee the annual compliance process and provide a report for publication.

10.7 If not, what is your view on the association becoming an SRO? Is it necessary, effective or not. Please give your observations/comments.

FSC has considered the approval of its Standards under the *Corporations Act 2001* but determined that such approval would not add to the effectiveness of FSC's standards and may in fact diminish the ability of FSC to respond to changes in the regulatory landscape by subjecting any change to its Standards to ASIC approval as required under section 1101A(2) of the Act.

11. Taxation of Retail Investment Funds

11.1 How are retail investment funds taxed at fund level? Please describe how dividend and interests received by funds are taxed? Please describe also how capital gains realized by sale of portfolio securities are taxed?

In Australia, managed investments are flow through vehicles, so that fund managers pass onto individual investors any dividends and tax credits accruing and the individual investors are subject to tax.

The Australia's system of dividend imputation allows Australian resident shareholders to receive a tax credit for any tax already paid by the company. The shareholder's income tax liability can then be reduced by the amount of the tax credit. This also applies to managed funds. If a managed investment vehicle holds Australian equities and receives franked dividends, the credit is passed onto the investor.

Where assets within the managed investment are sold by the manager, a capital gain is distributed to investors following the sale of investments and investors must then pay capital gains tax on their share of these amounts.

11.2 How are individual investors taxed on the distributions received from funds? How are they taxed on the capital gains on sales of funds?

Distributions from funds form part of individuals' assessable income and are thus taxed at the investor's normal marginal tax rates. Tax rates for 2016-17:

| Taxable income | Tax on this income |
|----------------------|---|
| 0 – \$18,200 | Nil |
| \$18,201 – \$37,000 | 19c for each \$1 over \$18,200 |
| \$37,001 – \$80,000 | \$3,572 plus 32.5c for each \$1 over \$37,000 |
| \$80,001 – \$180,000 | \$17,547 plus 37c for each \$1 over \$80,000 |
| \$180,001 and over | \$54,547 plus 45c for each \$1 over \$180,000 |

There is an additional 2% levy on incomes above a threshold (which depends on family circumstances), so the marginal tax rate is generally 2% higher than the above table for middle and high income earners.

Source: Australian Tax Office <http://www.ato.gov.au>

Australia's system of dividend imputation, introduced in 1987 to eliminate the double taxation of company profits, allows Australian resident shareholders to receive a tax credit for any tax already paid by the company. The shareholder's tax liability can then be reduced by the amount of the tax credit. This also applies to managed funds. If a managed investment vehicle holds Australian equities and receives franked dividends, the credit is passed onto the investor.

The company tax rate is 27.5% for businesses with turnover below \$10m and 30% for companies with turnover above this threshold.

Similarly, with regards to capital gains tax, the net capital gain is taxed at the applicable marginal tax rate. Where an asset has been held for more than one year, the capital gain receives concessional treatment. For individuals and trusts this results in at least a 50% discount, for superannuation (pension) funds the discount is 33.3% of the earnings tax payable.

11.3 Are there any tax incentives applied for financial products including investment funds? If yes, please describe the tax incentives.

Investment funds do not attract any special tax treatment. However, contributions to pension ('superannuation') funds are taxed at a concessional rate of 15% (compared to the marginal rates quoted above for individuals). Investment income in a superannuation fund is taxed at 15% while in the fund and capital gains earned by the fund are taxed at 10%.

11.4 Is there any tax incentive applied for investment funds only? If yes, please describe the tax incentives.

There are no tax incentives specifically for investment funds. However, once the retirement age of 60 has been reached, drawdown of the balance accumulated in a superannuation fund is tax free as are earnings inside the fund.