Exchange rate war won't be official

CURRENCY MATTERS

JOHN KICKLIGHTER

YOU won't hear officials from the US, eurozone or other major economic regions state that the world is embroiled in a global currency war.

Why? Because the definitions of what constitutes competitive devaluation of exchange rates (the definition of a currency war) is practically ambiguous.

In fact, it can be argued that the biggest players in the world are already engaged in a concerted effort to lower their own currencies. If they were to label one of their primary peers as a manipulator, blame would quickly come back to the accuser.

The term "currency wars" has been tossed around in investor and policy circles since modern monetary policy was adopted.

However, until recently there had been very few allegations of an explicit and pervasive effort. In the past six months, Japan has adopted a policy of guidance and stimulus that has driven the yen down 20 per cent against the US dollar. A move of this magnitude when general FX market conditions have proved unsupportive of major trend development cannot be sustained without a supranatural influence.

> Why should one country be barred from doing what the rest are engaging in?

The Group of Seven's unusual step of warning against currency manipulation, though not openly targeted at Japan, is a serious escalation on this international level, but to take further steps would require framing what specifically constitutes direct manipulation, and subsequently requires consequences that can have dramatic trade and financial repercussions.

This is something that policymakers want to avoid at all costs, considering the world's economy is struggling to maintain its economic recovery.

But let's consider a scenario where Japan's efforts were labelled outright manipulation. The spotlight would quickly turn to the Federal Reserve, which is engaged in a $US85 billion ($82bn) a month stimulus program, the ECB, which maintains a potentially unlimited government bond purchasing program (as yet unused), and the People's Bank of China, which has ballooned its own balance sheet.

Why should one country be barred from doing what the rest are engaging in? Would it be an issue of technicality (connecting a stimulus amount to an economic target)? Ultimately, the debate would evolve to an argument to reduce total stimulus around the globe. And that could prove disastrous as risk-taking investors are heavily supported by the presence of the major central banks in the markets. Is it worth potentially destabilising global sentiment to ensure one particular player isn't stimulating more effectively than the rest?

John Kicklighter is senior strategist at Dailyfx.

'Orphans' may suffer under financial advice changes

Advisers may still receive commissions from arrangements set up before July 1

LEO ALEXANDER

THE Future of Financial Advice legislation that comes into full force on July 1 may have the unintended consequence of seeing some consumers tricked by unscrupulous advisers into sticking with inferior superannuation arrangements, to maintain the adviser's flow of trailing commissions.

The FoFA legislation was aimed at increasing the quality, access and transparency of the financial planning industry. It passed parliament on June 25.

The biggest single element is a ban on product commissions being paid to financial advisers from July 1, with some exclusions such as commissions on life insurance products.

But FoFA will apply only to transactions after July 1. All the existing products and policies of thousands of Australians will not fall under FoFA and grandfathering provisions will apply.

There has been a lot of speculation that the government is looking to cut back this generous grandfathering because, as it stands, this would effectively mean that financial advisers could continue to receive commissions paid to them from arrangements if they set them up before July 1.

This legacy issue will remain live for at least another 50 years until all current products that pay commissions to financial advisers have been redeemed or closed by the investor-customer.

Although FoFA prescribes a statutory best interest duty that financial advisers must follow, the grandfathering provisions create an enormous potential conflict of interest for financial advisers. The duty means that financial advisers must put clients' interest above their own where there is a potential conflict of interest, and the grandfathering provision of FoFA is sure to test this.

There has been a sharp trend in the financial planning industry across the past 24 months to move existing commission business models to a fee for service structure whereby the financial planning business is "FoFA ready".

This includes changing the fee structures to hourly, retainer or asset-based fees and replacing the existing commission-based remuneration model.

Although most advisers have their clients' best interest at heart and have been active in moving clients to new FoFA-approved fee models, there will be a small percentage of the industry that will seek to avoid the legislation, to the detriment of the consumer.

It would work like this. Say under the new regime a consumer with an existing super product calls their adviser, who is receiving a commission on that superannuation account.

The consumer wishes to review their arrangement with a view to moving to an account with lower fees, presumably because the account fees are expensive as commission is built into the fee charged to the customer.

The adviser has two options.

First, comply with FoFA legislation and conduct a review of the client's super arrangements and recommend a new fee for service product, with the appropriate statement of advice provided.

However, doing so triggers FoFA and the client will no longer be considered under the grandfathering arrangements and must be brought into the new system.

Second, the adviser convinces the client a review is not necessary and no action is taken.

In this case the client remains under the grandfathering provisions and the financial adviser enjoys ongoing product commissions without FoFA requirements such as biannual opt-in requirements and annual fee disclosure letters.

> A small percentage of the industry will seek to avoid the legislation

The real problem comes with what we in the industry call orphan clients, who were advised to buy a product years ago but may not know they pay a trailing commission to a particular firm.

About half of financial planning firms have long had marketing plans to try to contact their orphan clients.

While there's the obvious intention to try to generate more business, it's a responsible course of action at several levels, and post-FoFA will almost certainly result in the trailing commission ending as a new statement of advice is devised.

But about half of the firms are happy to let that sleeping orphan lie and enjoy the grandfathered trailing commissions as they come in. Why make a call that could end a commission stream?

In the wake of FoFA there will be more financial planning firms that leave orphans alone to keep them under the lucrative old system, unless there is a big public push by, for instance, the industry funds to alert consumers to the fact they may have an adviser getting commissions they don't even know about.

The government has tried to anticipate and discourage this behaviour through the statutory best interest duty and also anti-avoidance provisions of FoFA but the law is only as good as it can be enforced. It may be very difficult to prove a financial adviser's intention to avoid FoFA.

Thus the unintended consequence may be that many Australians who FoFA is trying to protect may actually end up being disadvantaged as their financial adviser ducks and hides to avoid moving into the new fee-based system.

There are rumblings that many advisers who are considering retirement across the next five to 10 years will choose to gradually run down their financial planning book by treating it as an income stream and not actively service their clients, while enjoying the trailing commissions from clients who stay until they eventually get sick of no service and leave.

While it is clear there are many benefits of FoFA for consumers in terms of transparent fee arrangements and improvements in the required standard of service, the failing of FoFA may be the inability to appropriately protect consumers who have financial advisers who receive commissions and fall under the protected grandfathering provisions of FoFA. There is a strong potential for some of these consumers to be in a worse position as their financial advisers pull every trick in the book to avoid them, and FoFA.

Leo Alexander is the pen name of a practising financial adviser.

Registration clock ticking for auditors

MONICA RULE

JANUARY 31 saw a new registration system brought into being by the federal government as part of the MySuper reforms, starting on that date and with a "drop dead" cut-off on June 30.

As from July 1, all self-managed superannuation fund auditors will have to be registered with the Australian Securities & Investments Commission and meet minimum competency requirements in order to conduct SMSF audits.

The registration process has been designed to ensure that SMSF auditors possess the necessary skills and knowledge to perform their role.

The rule that comes into force on July 1 will also apply to audits for past financial years, if the audits are conducted after June 30 this year.

While this might look like another piece of regulation, it will have the positive effect of reminding people that there is more to auditing an SMSF than "ticking and flicking" someone else's work, not to mention that a bad auditor could cost you your life savings.

An SMSF auditor is responsible for performing financial and compliance audits of an SMSF and reporting any contraventions of the superannuation law to the Australian Taxation Office.

Although your accountant is responsible for putting together your financial documents based on transactions made by your SMSF throughout the financial year, the auditor's role is to check these papers, as well as other source documents, to ensure they reflect the true financial position of your fund and that your SMSF complies with all provisions of the taxation and superannuation law.

The auditor must check that all assets of the fund are correctly registered in the name of the SMSF; that any borrowing entered into by the SMSF is structured correctly; that the SMSF has not lent money to a related entity greater than the allowable 5 per cent limit, and; that the fund has adhered to contribution and payment standards. If the SMSF has contravened any provisions of the superannuation law then the trustees of the SMSF are informed and the contraventions are reported to the ATO.

Some trustees do not like their SMSFs being reported to the ATO and look upon this as being disloyal. However, by not reporting a contravention an auditor could get into trouble with the ATO if their working papers were audited.

It could be regarded by the ATO as either the auditor does not understand the superannuation law or the auditor did not do a proper audit.

In my opinion, an auditor's role is an extremely important one as the ATO relies on auditors to be its eyes and ears. There are more than 450,000 SMSFs in Australia and it would be impossible for the ATO to audit every single one to ensure they comply with tax and superannuation laws. Therefore, the ATO relies on auditors to act as gatekeepers in providing independent opinions on SMSFs' financial reports and compliance with legislation requirements.

ASIC recently issued Regulation Guide 243 that explains how to apply for registration, the types of registers of SMSF auditors maintained by ASIC, and the transitional arrangements for the registration of existing approved auditors of SMSFs. Applications for registration can be made now. Transitional arrangements have been developed for existing SMSF auditors to give recognition to highly experienced, competent professionals. Details can be found at the ASIC website.

If an existing SMSF auditor does not register with ASIC by July 1, they will not be able to continue with such work after that date. If an auditor has lodged an application for registration but it has not been assessed by ASIC by June 30, then they will not be able to audit funds until they have been notified that their application has been approved. Therefore, it is important to register by April 30 to ensure the application can be processed by June 30. Once registered, ASIC will issue an SMSF auditor number (SAN). This number will be required to be recorded on audit reports provided to trustees of SMSFs as well as other required reports to ASIC and the ATO. From July 1, trustees must only use ASIC-registered auditors who can provide a SAN number. The ATO will continue to monitor the performance of auditors.

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Flow of easy money finally delivering the goods as shock of the GFC fades

DON STAMMER

IN the past 12 months, Australian shares have delivered average returns of 20 per cent, global shares 16 per cent, Australian bonds and global bonds 7 per cent each, and listed property a bit over 30 per cent.

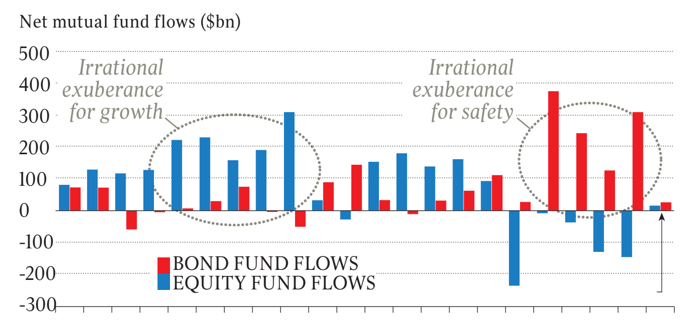
Even the year's underperforming asset classes — cash, investment housing and gold — have posted positive above-inflation returns.

These happy outcomes mainly reflect the easy settings in monetary policy in the big economies.

Official cash rates are exceptionally low — at near-zero levels in the US and Japan and 0.75 per cent in Europe — and have been supplemented by "unconventional" measures. For example, the US central bank is committed to keeping its cash rate at a negligible level for an extended period and is aggressively buying government debt from the public.

The accommodating settings in monetary policy haven't restored high rates of economic growth in the US, Europe or Japan. But via three key linkages, they've boosted investment returns worldwide.

US investors are beginning a switch back to equities



Source: AMP Capital

First, there's the growing perception that the major central banks are willing to do "whatever it takes" (as the European Central Bank worded it in July) to "preserve" financial confidence and reduce the risk of renewed global recession. This has helped to rebuild investors' confidence and reduce volatility in investment markets.

Second, with official cash rates at skinny levels, the "hunt for yield" has become the dominant theme in investment markets and the average prices of shares, listed property and corporate bonds have been bid up.

Third, the liquidity the major central banks are creating is "spilling over" into asset markets.

There's nothing sinister about this. Asset markets are one of the transmission channels through which changes in monetary policy ultimately influence spending, business activity, jobs and inflation. Adjustments in monetary policy usually affect asset markets before their full effects are felt on the real economy.

Investors can expect the big economies to maintain their accommodating monetary policies for extended periods.

The US central bank is committed to continue with low interest rates and aggressive bond purchases until unemployment falls to 6.5 per cent (it's currently 7.9 per cent) or the inflation outlook becomes a worry.

In Europe, the central bank may cut its cash rate further to help lift the eurozone out of recession.

Japan's central bank is intent on reintroducing inflation. And China, which avoided a hard landing without reducing interest rates, is likely to further relax controls on bank lending.

John Plender, a British commentator, recently reminded investors that "the nature of a market driven by central bank liquidity is that momentum triumphs over fundamentals".

He's right. But as this year progresses, the big question will be whether the easy settings in monetary policy in the major economies give a useful boost to spending, jobs, profits and inflation and if so, when. For much of the time since the global financial crisis erupted, market expectations have been that stimulatory monetary policy wouldn't do much to restore the rates of economic growth we'd seen over recent decades. The prevailing view was that we should expect a "new normal" of reduced growth, high unemployment, sluggish profits and low investment returns.

In the US, at least, sentiment is changing. Memories of the financial crisis are fading. Banks are functional again. House prices have begun to rebound. Sharemarkets are close to earlier peaks. Businesses are cashed up. And household indebtedness is much reduced.

My guess is we'll hear increasing comment this year that US monetary policy is gaining "traction"; that monetary policy is effective but operates with "long and variable lags".

Currently, low interest rates and abundant liquidity are driving global investment markets.

By next year, and led by the US, the easy settings of monetary policy in the big economies could be delivering a welcome pick-up in global growth and confidence and strong investment fundamentals for shares and property.

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