MAA255 Notes

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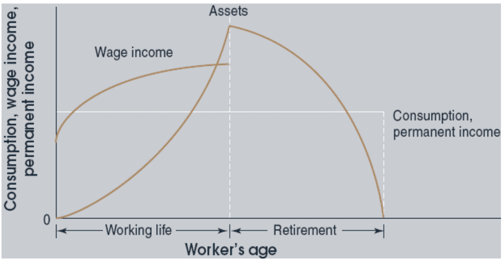
Topic 1 – The need For, and The Regulation of, Financial Planning

<u>Concept 1 – Why financial planning?</u>

- What is FP; preparation of personal financial statements, identifying goals and time frames and understanding risk and impact of risk.
- Time frames; short (1yr), medium (up to 5years), long (up to 40 or even more years)
- Realistic goals; specific or quantifiable and referenced to a specified time frame.
- Why is FP important; allows people to set in place personal objectives and arrange financial means to satisfy these objectives.
    - Life cycle theory of consumption and saving; framework to meet objectives



← Income and expenditure
While consumption is relatively smooth overs a person's life cycle, lifetime income is quite uneven.

- Personal financial planning is increasing in importance for number of reasons
    1. Increasing numbers in older age groups; falling birth/death rates, less immigration
        a. Baby boomers group is large. 5 workers for every retiree, by 2020 is will be 2.7
        b. Implications for the Govt to pay aged pensions, more reliance on Super
    2. Increase in longevity; in 1900s 55 for men, 59 for women, now 80 for men, 84 for women, by 2050 92 for men and 84 for women
        a. Vast improvements in medical science, Changes in dietary habits, Awareness of health issues and the need for regular exercise
    3. Restricted access to age pension- 65 now, 67 in 2017, 70 by 2035
        a. Government incentive to urge people to work longer, work bonus scheme
    4. Compulsory Superannuation Contribution; in 1992 at 3%, now 9.5%, 12% by 2022/23
        a. Tax incentives for self-employed, & incentives to encourage additional savings
    5. Choice of Superannuation Fund; competition was to force fees to be reduced
        a. MySuper; low cost super alternative for those that don't exercise their choice
    6. Retirement Benefits provided by Employers; from defined benefit to accumulated
        a. Individuals must take responsibility for their own retirement, planning must start at an early age to maximize retirement benefits, complexity of products, rules and decision making requires individuals to become better educated regarding personal financial decisions.
    7. Non Retirement Reasons
        a. Significant life events, e.g. Changing family, health or employment circumstances, Budgeting, Investment strategies (inside and outside of super), Tax minimization strategies, Maximize social security benefits, Estate planning, Identify and manage financial risks

<u>Concept 2 – Risk and The Economic Environment</u>

- Risk types
    1. Mismatch risk; mismatching a persons objective, investments and time frame
    2. Inflation risk; real value of investments are eroded over time
    3. Interest rate risk
        a. Reinvestment risk; when fixed assets mature, must reconsider IR
        b. Market volatility; When fixed-rate investments are sold the full value of investment may not be realized – this will occur if market interest rates rise during the holding period.

4. Market risk; ups and downs, some markets are more volatile than others
5. Market timing risk; difficult to choose when to enter or exit the market
6. Lack of diversification risk; reduces overall risk, diversify across range of assets
7. Currency risk; applies if investments are foreign currency, exchange rate fluctuations
8. Liquidity risk; access to cash for emergency purposes
9. Credit risk; with securities such as term deposits, debentures, mortgages and bonds
10. Legislative risk; Govt. change current laws/regulations, may be favorable or not
11. Gearing risk; Investor borrows money to invest, loan must be repaid even if underlying investment decrease in price.

- Business cycle
    1. Boom or expansion; employment, eco growth are high, ↑ inflation is concerning
    2. Contraction; eco growth starts to slow, sales begin to fall, unemployment rises
    3. Recession; high unemployment, low (or negative) eco growth
    4. Recovery; unemployment begins to falls, eco growth starts to rise

- Both monetary and fiscal policy used to 'manage' the local economy
- Monetary policy is conducted via controlling the money supply, which in turn impacts on interest rates
- Fiscal policy involves government intervention in the economy via taxation and spending policies

<u>Concept 3 – The Financial Planning Environment</u>

- Major events in the development of financial planning:
    - 1980s; 'Rollover' superannuation funds (1983), Capital Gains Tax and fringe benefits tax (1985-86), Imputation credit on company dividends (1987)
    - 1990; Introduction of compulsory superannuation (1992), Wallis report - deregulation of financial services (1997)
    - 2000s; Financial Services Reform Act (2001), Proposed changes under 'Simple Super' (2006 – 07), Age pension asset and income tests (2007), Major reviews of the financial planning industry (2008 – 10)
    - 2010s; Future of Financial Advice (2011). Introduction of 'MySuper' default fund (2011), FSI and PJCCFS reviews (2014) PAGE 24-33

Act	Administering body
Corporations Act 2001	Australian Securities and Investments Commission (ASIC)
Financial Services Reform Act 2001 (FSRA)	ASIC (incorporated into the *Corporations Act 2001*)
Insurance Contracts Act 1984	ASIC, the common law and the court system
Superannuation Industry (Supervision) Act 1993	The Act and its regulations and ancillary legislation are administered by the Australian Prudential Regulation Authority (APRA); other parts administered by ASIC
Superannuation (Resolution of Complaints) Act 1993	ASIC
Life Insurance Act 1995	Parts are administered by both APRA and ASIC
Australian Securities and Investments Commission Act 2001	ASIC
Future of Financial Advice 2011	ASIC (incorporated into the *Corporations Act 2001*)

- Corporations Act 2001; licensing regime for provision of financial services and products, rights and obligations of licensees in the appointment of authorized representatives, definition of 'financial product' and 'financial service' and of retail and wholesale clients
- Financial Services Reform Act (FSRA) 2001; Objectives are to - promote confident and informed decision making by consumers of financial products and services, promote fairness,