The Parliament of the Commonwealth of Australia

REPORT ON THE FINANCIAL SERVICES REFORM BILL 2001

PARLIAMENTARY JOINT STATUTORY COMMITTEE ON CORPORATIONS AND SECURITIES

AUGUST 2001

The Parliament of the Commonwealth of Australia

REPORT ON THE FINANCIAL SERVICES REFORM BILL 2001

PARLIAMENTARY JOINT STATUTORY COMMITTEE ON CORPORATIONS AND SECURITIES

AUGUST 2001

© Commonwealth of Australia 2001

ISBN 0 642 71095 3

This document was produced from camera ready copy produced by the Parliamentary Joint Statutory Committee on Corporations and Securities Secretariat and printed by the Senate Printing Unit, Parliament House, Canberra.

MEMBERSHIP OF THE COMMITTEE

Senator Grant Chapman, (Chairman)

Mr Bob Sercombe, MP, (Deputy Chairman)

Senator Stephen Conroy

Senator Barney Cooney

Senator the Hon Brian Gibson

Senator Andrew Murray

Ms Julie Bishop, MP

Mr Ross Cameron, MP

Mr Kevin Rudd, MP

Dr Andrew Southcott, MP

Committee Staff

Mr David Creed, Secretary

Mr Patrick McCormack, Principal Research Officer

Ms Loes Slattery, Senior Research Officer

Ms Judith Wuest, Executive Assistant

Ms Adele Glover, Executive Assistant

DUTIES OF THE COMMITTEE

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the duties of the Committee as follows:

The Parliamentary Committee's duties are:

(a) to inquire into, and report to both Houses on:

  (i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

  (ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

TABLE OF CONTENTS

Membership of the Committee iii

Duties of the Committee vi

CHAPTER 1 **1**

THE COMMITTEE'S INQUIRY **1**

CHAPTER 2 **3**

BACKGROUND TO THE BILL **3**

Changes to the exposure draft Bill 4

Summary 11

CHAPTER 3 **13**

OUTLINE OF THE BILL **13**

Objects of Part 7 13

Key definitions 13

Definition of financial product 14

Definition of financial service 14

Licensing of financial markets 15

Licensing of clearing and settlement facilities 15

Limits on involvement with licensees 16

Compensation arrangements 16

Licensing of providers of financial services 16

Disclosure and other conduct requirements for licensees 17

Other provisions relating to conduct 18

Financial product disclosure 18

Market misconduct and other prohibited conduct 19

Title to securities and other matters 19

Telephone monitoring during takeover bids 19

Amendments 19

Possible Future Amendments 21

Timing and Transitional Arrangements 22

CHAPTER 4 23

SUPPORT FOR THE BILL AND PROCESS ISSUES 23

Introduction 23

Support for the Bill 23

Concerns about the process 25

ASIC: administrator and regulator of financial reform 26

Timing and consultation 29

Transitional licensing arrangements 31

CHAPTER 5 35

POLICY ISSUES RAISED BY THE BILL 35

Introduction 35

Overview of issues raised 35

Revoking of the media exemption 36

Telephone tape recording proposal 41

Issues relating to Australia as an international financial centre 45

Issues raised by authorised deposit taking institutions (ADI) 48

Issues which affect small business 50

Issues relating to the insurance industry 54

Issues relating to declared professional bodies 58

Consumer protection issues 61

Superannuation 75

CHAPTER 6 85

CONCLUSIONS AND RECOMMENDATIONS 85

Support for the Bill 85

Concerns about the process 85

Revoking of the media exemption 86

Telephone tape recording proposal 87

Issues relating to Australia as an international financial centre 88

Issues raised by authorised deposit taking institutions (ADI) 89

Issues which affect small business 89

Issues relating to the insurance industry 91

Issues relating to declared professional bodies 93

Consumer protection issues 94
Superannuation 94

APPENDIX 1 **97**

SUBMISSIONS RECEIVED **97**

APPENDIX 2 **103**

WITNESSES AT HEARINGS **103**

LABOR MEMBERS MINORITY REPORT **107**

AUSTRALIAN DEMOCRATS SUPPLEMENTARY REPORT **117**

CHAPTER 1

THE COMMITTEE'S INQUIRY

1.1 On 11 February 2000 the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, released the exposure draft Financial Services Reform Bill for public comment. On 8 March 2000 the Parliamentary Joint Statutory Committee on Corporations and Securities resolved to inquire into the Bill.

1.2 The Committee received submissions and held public hearings on the Bill and subsequently tabled its report on the Bill on 14 August 2000.

1.3 On 28 March the Parliamentary Joint Statutory Committee on Corporations and Securities resolved to inquire into and report on the Financial Services Reform Bill 2001 once it had been introduced into the Parliament. Shortly thereafter the Government released its response to the Committee's report of 14 August 2000.

1.4 The Financial Services Reform Bill 2001 was subsequently introduced into Parliament on 5 April 2001.

1.5 On 10 April 2001, the Committee advertised nationally inviting submissions from interested parties. Written submissions in all totalled 97 plus several supplementary submissions. A list of those who made submissions is included as Appendix 1 to this report.

1.6 Public hearings were held in Melbourne on 27 April 2001; in Sydney on 13 and 14 June 2001; and in Canberra on 25 and 27 June 2001. A list of witnesses who appeared before the Committee is shown in Appendix 2.

1.7 On 13 June 2001 the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, wrote to the Chairman of the Committee advising that the draft Bill would be amended in the House of Representatives before the Committee had tabled its report. The Committee advised the Minister that it was not opposed to this action and would consider the amendments in its final report.

1.8 Minister Hockey's letter of 13 June 2001 also advised that the following bills would affect the Financial Services Reform Bill regime, namely:

- Financial Services Reform (Consequential Provisions) Bill
- Corporations (Compensation Arrangements Levy) Bill
- Corporations (National Guarantee Fund Levies) Bill, and
- Corporations(Fees) Amendment Bill

1.9 On 25 June 2001 the Minister again wrote to the Chairman detailing amendments that were to be made in the House of Representatives. The House passed the Bill, with amendments, on 28 June 2001.

1.10 The Minister's letter of 25 June 2001 also advised that further amendments are under consideration.

1.11 All submissions and the Hansard of the Committee's hearings on the Bill are tabled with this report. Copies of submissions are available on request from the Committee staff on (02 6277 3580). The Hansard of the hearings is available at the Parliamentary website (www.aph.gov.au/hansard/joint/commttee/comjoint.htm).

1.12 The Committee acknowledges the assistance of those who made submissions or who appeared as witnesses, many of whom did so at short notice. The Committee is grateful for this assistance.

CHAPTER 2

BACKGROUND TO THE BILL

2.1 The Financial System Inquiry was charged with providing a stock-take of the results arising from the financial deregulation of the Australian financial system since the early 1980s. The Inquiry also analysed the forces driving change in the financial system, in particular, technological development.

2.2 The Financial System Inquiry reported to the Treasurer in early 1997 and made recommendations as to the regulatory arrangements that will best ensure an efficient financial system. The Inquiry concluded that the existing complex and fragmented regulatory framework was creating inefficiencies for financial service providers and confusion for consumers.

2.3 In his second reading speech on the current Bill the Minister, the Hon. Joe Hockey MP, noted that the Financial System Inquiry report, known as the Wallis report, had recommended the introduction of a single licensing regime for all financial sales, advice and dealing and the creation of a consistent and comparable product disclosure framework. It had also suggested that such changes would generate substantial benefits for both the industry and consumers.

2.4 Responding to the Inquiry's report, the Treasurer, in March 1997, announced the Corporate Law Economic Reform Program which he stated would review fundamentally key areas of regulation which affect business and investment activity and make recommendations for improvement.

2.5 The Corporate Law Economic Reform Program was intended as a response to developments in the international and domestic business environments which had made the streamlining of Australia's corporate law necessary if the Australian economy was to meet the demands of contemporary business.

2.6 The various elements of the Corporate Law Economic Reform Program were developed after consultation with the business community and the Business Regulation Advisory Group. It is the sixth stage of this Reform Program which ultimately has resulted in the production of the Financial Services Reform Bill which is the subject of this Committee's report.

2.7 A position paper—*Financial Markets and Investment Products*—released in December 1997 was followed by a consultation paper, titled *Financial Products, Service Providers and Markets—An Integrated Framework* of March 1999. An extensive consultation process then followed. An exposure draft of the Financial Services Reform Bill was then released in February 2000.

2.8 The Parliamentary Joint Committee on Corporations and Securities held an inquiry into the exposure draft Bill and tabled its report on 14 August 2000. In this

report the Committee made a number of recommendations regarding the exposure draft for the Government to consider during its preparation of the final form of the legislation.

2.9 The current version of the Financial Services Reform Bill, which is an integral part of the Government's legislative response to the Financial System Inquiry, has been modified in the light of the recommendations of the Committee's report of August 2000, and extensive consultation which the Department of the Treasury carried out in relation to the exposure draft Bill.

2.10 The Committee's recommendations on the exposure draft Bill and the Government's response to them, are discussed below.

Changes to the exposure draft Bill

2.11 The Government's response to the Committee's report indicated that the Government either fully or partially accepted the majority of its recommendations. This has resulted in key changes being made to the exposure draft Bill.

2.12 The Committee notes that a number of other changes between the exposure draft Bill and the current Financial Services Reform Bill resulted from the extensive consultation that the Department of the Treasury conducted on the exposure draft Bill.

2.13 The eight recommendations made by the Committee in its report of August 2000, and the Government's response to those recommendations, are discussed below.

1) Passage of final Bill

2.14 The Committee concluded that there was general support for the aims of the exposure draft, however, most submissions included suggestions for improving the manner in which the Bill had been drafted. Subject to these drafting changes, and the Committee's other recommendations, the Committee recommended that the draft Bill proceed and be considered the foundation for a final Bill that would be passed by the Parliament.

2.15 The Government welcomed the recommendation to pass a final version of the Financial Services Reform Bill and stated that it would finalise the drafting of the final Bill as soon as practicable. The Bill currently before the Committee is the product of that work.

2) Adverse effects of the draft Bill on rural and regional areas

2.16 The Committee concluded that there was considerable disquiet among financial institutions concerning the inclusion of basic banking products within the purview of the exposure draft Bill. This inclusion was regarded as imposing requirements on approved deposit taking institutions which could cause these institutions to terminate services, notably those offered in rural areas, because those services would become non-viable.

2.17 The termination of the provision of basic banking products in rural areas would have an unacceptable effect on local rural communities. In cases where such services were offered on an agency basis by another business, the termination of the agency could result in the business operating the agency also ceasing to trade.

2.18 The disclosure and training requirements of the draft legislation, while appropriate for more complex financial products, were found by the Committee to be inappropriate for basic banking products where few concerns had been expressed about any shortcomings in consumer protection. The Committee also recognised that imposing such requirements on basic banking products was not in accordance with the express intent of the Wallis Inquiry on this matter.

2.19 The Committee consequently recommended that the exposure draft Bill be amended as follows :

AMENDMENT TO DEFINITION OF FINANCIAL PRODUCT

A facility or arrangement provided by an authorised deposit taking institution within the meaning of the *Banking Act 1959* (Cth) shall not be taken to be a financial product where:

(1) (a) the facility or arrangement is a deposit of funds received in the course of banking business; and

(b) the amount of funds held on deposit cannot, under the terms and conditions governing the facility or arrangement, diminish other than as a consequence of one or more of:

(i) a withdrawal or transfer on the instructions or by the authority of the depositor;

(ii) a debit authorised by the depositor for the payment of fees or charges; or

(iii) a payment of government charges, or duties, on receipts or withdrawals; or

(iv) the exercise of any right to combine accounts or any right pursuant to a contract, lien or charge arising by operation of any Act, law or custom; or

(v) compliance with a court order or statutory obligation; and

(c) the amount of any return to the depositor, or the interest rate for calculating any return to the depositor, is fixed under the terms and conditions governing the facility or arrangement;

OR

(2) under the terms and conditions governing the facility or arrangement, the funds held on deposit may be withdrawn upon the demand, or under the authority, of the depositor;

OR

(3) the facility or arrangement provides a means of payment by which funds are drawn or transferred from, or paid to, a facility or arrangement described in (1) or (2).

2.20 The Government recognised the value of the Committee's suggestion and agreed to amend the exposure draft Bill so that deposit products offered by authorised deposit-taking institutions, for terms of 2 years or less with no management or break fees, would not be subject to the financial services guide requirements or requirements to provide statements of advice. This amendment would ensure that the final Bill's requirements apply in such a way that it recognises that basic deposit products are generally well understood by retail consumers and that consumers can get their money back on demand.

2.21 The Government also advised that it intended to make amendments to the exposure draft Bill's definitions of financial product advice and dealing, to ensure the requirements for licensing and authorisation are more tightly focussed. This would ensure that activities commonly engaged in by tellers, such as the accepting of moneys for deposit or the giving out of moneys from deposit accounts, would not be caught by the Financial Services Reform regime.

2.22 The Government noted that the Committee's report highlighted concerns about the Bill's competency requirements for representatives, such as tellers or employees of third party agents. In its response to the Committee's report, the Government stated that these concerns were unfounded and did not warrant the wholesale removal of deposits and means of payment from the exposure draft Bill.

2.23 The Government's response stated that the intention of these competency requirements was not to force every representative to be competent to provide full financial planning services. Rather, representatives would only have to be competent to provide the services they actually provide in the course of their regular duties—no more and no less. The Government stated that it did not expect industry participants who are adequately trained and competent to provide the services they now provide to have to undertake significant extra training to meet the draft Bill's competency requirements.

2.24 The Government also believed that the final form of the Financial Services Reform Bill would not hinder the operation of Rural Transaction Centres or distribution of deposit products through third-party agents such as newsagents or pharmacists in country Australia.

3) Information economy and e-commerce

2.25 The Committee concluded that e-commerce and other issues, particularly the issue of advice on non-financial products, should be addressed directly in the final Bill, if appropriate, or alternatively in the regulations or policy statements. In relation to non-financial products the Committee therefore recommended that the exposure draft Bill be amended as follows:

[insert at 766B (6) of exposure draft Bill]

For the purposes of this section, information that:

(a) is provided to a person in relation to the provision of a good or service that is not a financial product; and
(b) is not provided wholly or predominantly in relation to the provision of a financial product;

is not financial product advice.

2.26 The Government, in its response to the Committee's Report, welcomed the support for the information economy and e-commerce. The Government, however, stated that it did not believe it needed to amend the definition of financial product advice in the way recommended by the Committee, in order to address the concerns raised in evidence before the Committee on the information economy and e-commerce.

2.27 The Government therefore stated that the exposure draft Bill would be amended but only so as to clarify the application of its requirements in a range of e-commerce situations. For example, the Bill would be amended to make it clear that a person who merely provides a communication service through which a consumer makes a non-cash payment is not the provider of the non-cash payment facility.

4) Australia as an international financial centre

2.28 In relation to the exposure draft Bill, the Committee concluded that the evidence of the Australian Stock Exchange (ASX) raised important issues regarding Australia's international competitive position and role as a global financial centre. The Committee therefore recommended that the transitional and administrative measures suggested by the ASX be adopted.

2.29 The Government responded by declaring that it was keen to enhance Australia's role as an international financial centre but it was not convinced that the examples cited in evidence to the Committee by the ASX will have the effect of undermining the future of Australia's markets. In particular the Government's response stated that:

- the object of provisions relating to the regulation of foreign-based markets operating in Australia is facilitative—to ensure that those markets which are subject to an appropriate regulatory regime overseas are not, in addition, subject to the full rigours of the Australian regulatory regime. The

intention is that the regulation of such markets in Australia and overseas, when taken together, be equivalent to the regulation of a comparable market which is licensed only in Australia;

- the purpose of requiring that Australian incorporated bodies which operate a market or clearing and settlement overseas be licensed in Australia is to ensure that Australia does not lend its name to doubtful operators who may mislead overseas investors by implying that, since they are incorporated in Australia, they are regulated in Australia. Such a situation would adversely affect Australia's reputation as an international financial centre;
- the Government remains committed to providing regulation of financial markets through a combination of self-regulation, and regulation by the Minister and ASIC. A wide power of delegation to the regulator, ASIC, is necessary to ensure flexibility in the operation of the new legislation into the future, but it is expected that the Minister will continue to be the decision-maker in relation to the major markets.

2.30 The ASX raised in evidence the issue of increasing the shareholder limitation in the Exchange from 5 per cent to 15 per cent in line with the banking sector, with the possibility of a larger proportion, subject to a 'fit and proper' person test. The ASX also pointed to the need for an even-handed competitive environment.

2.31 The Government regarded this point as a valid criticism and so, on 10 October 2000, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, announced that the Government would raise the shareholder limitation in the Australian Stock Exchange to 15 per cent. The Government stated it would consider permitting a shareholding larger that 15 per cent if it were in the national interest. Minister Hockey also stated that the same shareholding limitations would apply to other financial markets and clearing and settlement facilities that are of national economic significance.

2.32 Minister Hockey announced that these changes to shareholding limitations would be included in the final version of the Financial Services Reform Bill and would complement the 'fit and proper' person test applying to controllers and senior managers of Australian markets and clearing and settlement facilities.

5) The impact on small business

2.33 The Committee concluded that the disclosure of commissions on risk insurance products, required by the exposure draft Bill, had the potential to impact unfairly on small business. The Committee supported retaining the requirement that persons selling risk insurance products be required to indicate that they will receive a commission, however, the Committee recommended removing the requirement that the quantum of the commission be disclosed automatically.

2.34 The Government's response rejected this particular recommendation.

2.35 The Government stated that the purpose of disclosure was to help the consumer identify potential influences on the advice given, or potential conflicts of interest, which the adviser may have in recommending a specific product. The Government's view was that consumers need to know the quantum of commissions in order to assess the seriousness of possible conflicts an adviser may have in recommending a product.

2.36 The Government regarded the disclosure of benefit or advantage as essential to ensure that consumers were provided with information that will help them make an informed choice about whether to purchase a product or not. According to the Government's response, the disclosed information would help the consumer evaluate any possible influences on the adviser in recommending a particular product.

6) Co-regulation and the position of professional bodies

2.37 The Committee noted the concerns expressed by the Law Institute of Victoria (LIV) and the Accounting Bodies about the exposure draft Bill. The Committee recommended that the final Bill or the regulations clarify the position of members of the Law Institute of Victoria (LIV) and the Accounting Bodies. The Committee also recommended that co-regulation be expanded to include as wide a range as possible of other areas of the financial services sector.

2.38 The Government also rejected this recommendation.

2.39 The Government's response to the Committee's Report stated that, from consumers' perspective, the loss they might suffer from poor financial advice given by, for example, an accountant who provided that advice incidentally to accounting services, is no less serious than the loss they would suffer if the poor advice had been given by someone whose main activity was the provision of financial advice, for example, a financial planner.

2.40 The Government therefore found it necessary to retain provisions in the Bill requiring anyone who provided defined financial services be competent to do so. This requirement would apply irrespective of whether the service providers call themselves insurance agents, financial planners, accountants or lawyers. Generally speaking, providers of financial advice would require an Australian Financial Services Licence.

2.41 In light of submissions on the exposure draft Bill, the Government did amend the definitions of financial product advice and dealing, to ensure that it would be clear what activities would attract the operation of the Bill.

7) Proper recognition of corporate structures under the retail/wholesale client definition

2.42 The Committee concluded that the concerns expressed by the Commonwealth Bank, the Australian Bankers' Association and others about the failure of the draft exposure Bill to recognise that a typical Australian financial corporate structure was a conglomerate, are valid. The Committee therefore recommended that the final Bill

expressly provide exemptions in relation to the operation of related entities within a conglomerate. The Committee also recommended that anomalies in the distinction between wholesale and retail clients be addressed.

2.43 The Government responded to this recommendation by making amendments to the Financial Services Reform legislation to accommodate conglomerate structures where staff are employed by a single corporate entity within the group.

2.44 The Government stated that, in relation to the potential capital gains tax consequences for existing industry participants in moving to the new licensing regime contained in the Financial Services Reform Bill, consultations have been occurring on this issue since February 2000. The Government also stated that it would consider whether any legislation would be necessary to deal with the tax consequences as a result of the Financial Service Reform Bill.

2.45 The Government response also indicated that, in relation to the retail/wholesale client definition, amendments would be made to align it more closely with the current definition in the *Corporations Act 2001* and to clarify that Financial Services Licensees and prudentially regulated bodies are wholesale clients.

8) Start date of the bill

2.46 Throughout the many submissions received by the Committee on the exposure draft Bill the issue of starting date was raised. The Committee recommended that consideration be given to the timing concerns raised by submitters:

- to avoid the adverse effects on the delivery of financial services in rural and regional areas;
- to ease the development of e-commerce and clarify the definition of financial product;
- to address issues raised relating to the international competitive position of Australia and its role as a global financial centre;
- to remove the requirement of disclosing the quantum of a commission on risk insurance products where return is unaffected by the level of commission;
- to clarify the position of legal and accounting practitioners and to expand the co-regulation model with respect to professional bodies;
- to address the anomalous position of employees in conglomerate corporate structures and the anomalies in the distinction between wholesale and retail clients;
- to address the timing concerns in relation to the start date of the new regime.

2.47 In its response the Government noted the Committee's recommendation that consideration be given to the timing of the Financial Services Reform regime to allow industry sufficient time to comply with the new regime. The Government stated that it

was keen to finalise, introduce and secure passage of the draft Bill as soon as possible, and that it would take account of the Committee's views, and those of the regulator and interested industry stakeholders, when determining when to commence the legislation.

2.48 The Government also noted that it proposed transitional provisions under which existing industry participants will be able to comply with some current requirements rather than the new law for a period of up to 2 years.

Summary

2.49 The Minister declared that the current Bill would 'enable financial service providers to reap the efficiencies and cost savings' identified by the Financial System Inquiry.

2.50 The Bill aims to give effect to the Minister's declaration:

- by introducing a 'harmonised licensing, disclosure and conduct framework for all financial service providers';
- by establishing a 'consistent and comparable financial product disclosure regime';
- by creating a 'streamlined regulatory regime for financial markets and clearing and settlement facilities'.

2.51 The Bill recognises that it is no longer possible for different financial institutions, services and products to be regulated under separate regulatory frameworks. The Bill therefore substitutes a single framework to regulate financial institutions, services and products in place of the current separate regulatory frameworks. The Bill will thus enable Australia's regulatory framework to keep pace with current developments in the financial services industry.

2.52 The Bill provides for the removal of regulatory barriers to the introduction of technological innovations and thus assists Australia's financial services industry to meet the technological challenge posed by the spread of e-commerce. The Bill's objective is to ensure that Australian financial service providers that seek to compete in the global marketplace are not disadvantaged under Australia's domestic regulatory framework.

2.53 According to the Minister, the 'streamlined regulatory regime proposed in the Bill aims to reduce the compliance costs associated with carrying on a financial services business.' The Bill therefore would bring particular benefits to financial institutions that seek to provide their clients with a full range of financial services and products. However, it has been 'carefully crafted' to ensure that specialist providers and small businesses will not be disadvantaged.

2.54 Another purpose of the Bill is to benefit consumers:

- by introducing a consistent framework of consumer protection;
- by enhancing the capacity of consumers to understand and compare different financial products and evaluate financial advice;
- by ensuring that consumers can access appropriate complaint handling mechanisms for resolving disputes with financial service providers.

2.55 The Bill provides protection for individual and small business consumers without imposing higher costs on wholesale transactions between sophisticated professional investors that operate in a competitive global market.

2.56 The regulatory framework is designed to be capable of flexible implementation so that it can apply differently to different products where this difference can be justified within its overall objectives. For example, basic deposit products will be subject to less intensive regulation than more complex investment products. Thus the Bill aims not to jeopardise the cost-effective provision of basic banking services, especially in rural and regional areas.

2.57 The Bill also provides financial service providers with the flexibility to adopt corporate structures and distribution channels that best meet their commercial objectives.

CHAPTER 3

OUTLINE OF THE BILL

3.1 The Department of the Treasury advised the Committee that the modifications made to the exposure draft Bill to produce the current Financial Services Reform Bill were 'significant' in number. These modifications, according to Treasury, affected all aspects of the Bill and were mostly, but not entirely, of a 'minor or technical' nature.

3.2 The provisions of the Bill, noting 'significant' changes from the exposure draft Bill, are discussed below.

Objects of Part 7

3.3 The current Bill proposes that Chapters 7 and 8 of the Corporations Law[1] be replaced by a new Chapter 7 which is set out in schedule 1 of the current Bill. The key changes that this will bring about in the Corporations Law, and the key changes between the exposure draft Bill and the current Bill are discussed below. At the end of this discussion another section deals with the recent amendments to the current Bill.

Key definitions

3.4 Part 7.1 contains the key definitions applicable to proposed new Chapter 7 of the Corporations Law. These definitions will replace some of the existing definitions in the Corporations Law and they are drafted so that they are capable of application to the full range of financial products that are to come within the purview of Chapter 7. For example, the concept of 'able to be traded' will replace the term 'admitted to quotation' in relation to Chapter 7 to reflect the fact that the provisions will apply to all financial products markets, not just securities. Similarly, the concepts of 'acquire' and 'dispose' have been defined broadly to capture the wide range of products subject to Chapter 7.

3.5 The Bill draws a distinction between retail clients and wholesale clients. Retail clients benefit from additional protection in the form of:

- the Financial Services Guide;
- the Statement of Advice;
- product disclosure documents; and
- compensation and complaint handling arrangements.

---

1 When the current Bill was drafted it referred to the Corporations Law. On 28 June 2001, however, the Corporations Bill 2001 received Royal assent. References to the Corporations Law should therefore now be deemed to be references to the new Corporations Act.

3.6 This definition seeks to accommodate the range of products and services that come within the financial services regime. The Bill distinguishes between general insurance products and other kinds of financial products. The test for 'retail client' is different for these two categories of financial products.

3.7 An important change between the exposure draft Bill and the current Bill is the addition of the new subclause 761(G)(6) the effect of which is to define persons receiving superannuation products, or retirement savings account products, as retail clients—'regardless' of the circumstances of the provision of the product, or the circumstances of the provider or client. The additional protection afforded to a retail client therefore will apply to clients seeking superannuation and retirement savings account products.

Definition of financial product

3.8 The Bill begins with a broad general definition of financial product, which focuses on the key functions performed by financial products. This general definition is then clarified or added to by a list of specific inclusions and a regulation-making power to include further products. The scope of both the general definition and the specific inclusions is then narrowed by a list of specific exclusions, a regulation-making power to exclude products and an ASIC exemption power.

3.9 The general definition focuses on three key functions that financial products perform:

- making a financial investment;
- managing a financial risk; and
- making non-cash payments.

3.10 An important difference between the exposure draft and the current Bill is the inclusion of paragraph 764A(1)(k). This addition to the current Bill deems spot foreign currency transactions to be financial products for the purpose of being regulated by the Bill.

3.11 Paragraph 764A(1)(l) also is an addition to the exposure draft. This addition subjects certain managed investment schemes, equitable rights in such schemes, and options to acquire equitable rights in such schemes, to be deemed financial products subject to the operation of the Bill.

3.12 Paragraph 765A(1)(x) is also new. It exempts the equipment and infrastructure used to provide financial products from the operation of the Bill. Without this addition the providers of rooms, for example, in which insurance agents concluded contracts with clients, may have been subject to the provisions of the Bill.

Definition of financial service

3.13 Clause 766A of the current Bill deals with the defining marks that indicate that a person has provided a financial service. This clause has been altered from that in

the exposure draft so that '[t]o avoid doubt' it is now expressly stated that a person does not provide a financial service, and is thus not subject to the regulations relating to the provision of financial services, where that person merely performs 'work of a kind ordinarily done by clerks or cashiers'.

3.14 The current clause 766C similarly has been expanded from its counterpart in the exposure draft to make it clear the mere administrative activity is not 'dealing in a financial product' for the purposes of the current Bill.

Licensing of financial markets

3.15 The purpose of Part 7.2 set out in the Bill, is to create a single licensing scheme for securities and futures exchanges in a more flexible regulatory framework than the current multiplicity of licensing arrangements.

3.16 The Bill covers the different responsibilities allocated to the Minister, ASIC and market licensees in carrying out their respective functions in monitoring and promoting market integrity and consumer protection.

3.17 The current Part 7.2 exhibits many changes from its counterpart in the exposure draft Bill. Most of these changes are of a technical nature.

3.18 One change that was not of a technical nature was the removal of clause 799A in the exposure draft Bill. This clause had stated that 'an unacceptable ownership situation' would arise if any one person's voting power in the Australian Stock Exchange exceeded 5 per cent. Part 7.4, discussed below, replaces clause 799A.

Licensing of clearing and settlement facilities

3.19 Clearing and settlement facilities are the subject of Part 7.3. The purpose of Part 7.3 is to provide a more flexible and comprehensive regime for the regulation of clearing and settlement facilities. Instead of the two routes to authorisation provided in the current Corporations Law, there will be one.

3.20 The Bill permits access to the relevant transfer provisions by a wider range of facilities. The proposed provisions will permit, but not require, more than one clearing and settlement facility to handle the clearing and settlement of transactions executed on the one financial market.

3.21 The Bill does not increase the regulatory burden on those clearing and settlement facilities currently regulated under the Corporations Law. Rather than imposing additional obligations, some of the new provisions reflect aspects of the new, more complete framework not addressed in the current Law, for example, suspension of a licence.

Limits on involvement with licensees

3.22 Part 7.4 as set out in the current Bill appears to be an addition to what was set out in the exposure draft Bill. It is, however, a replacement for clause 799A in the exposure draft.

3.23 Clause 799A was to limit to 5 per cent the shareholding of any one entity in the Australian Stock Exchange. This 5 per cent limitation was deemed to unnecessarily restrict the ability of the Exchange to play a part in the global marketplace.

3.24 In place of this limitation, Part 7.4 of the current Bill applies a shareholding limitation of 15 per cent to financial markets and clearing and settlement facilities that are prescribed as being of national significance. However, it will be possible for the Minister to approve a larger shareholding in relation to a market or facility where this is in the public interest. The Explanatory Memorandum to the Bill contains guidelines for assessing whether a market or clearing and settlement facility is of national significance.

3.25 This Part also provides a new 'fit and proper person' test, in line with international developments in the regulation of exchanges and clearing and settlement facilities.

Compensation arrangements

3.26 The National Guarantee Fund and its administration are addressed in Part 7.5. In addition, requirements are prescribed for compensation arrangements to cover a retail client for specified losses of property entrusted to a participant in a financial products market, where the National Guarantee Fund does not apply.

Licensing of providers of financial services

3.27 Part 7.6 sets out when an Australian Financial Services License is required and who may apply for a licence. It provides that:

- persons seeking to carry on a financial services business will need to obtain an Australian Financial Services Licence;
- a licence will be required where services are provided to either wholesale or retail clients. Additional obligations will be placed on licensees who offer services to retail clients;
- licences may cover all financial services in relation to all financial products or a subset of services and products;
- licensees may authorise natural persons or corporate representatives to act on their behalf; and
- authorised representatives will be able to act for more than one licensee with the written consent of each licensee (cross endorsement).

3.28 Clause 911A in the current Bill corresponds to clause 881A in the exposure draft Bill. The new clause has a considerably expanded number of exemption categories that allow employees of representatives and corporate groups providing services in relation to basic deposit products, to be exempt from authorisation.

3.29 This change simplifies the operation of the Bill considerably and is justified on the grounds that employees acting as mere instruments are merely carrying out the directives of others, and it is those others, and only those others, logically, who should have to be authorised.

3.30 In Part 7.6, clause 916B in the current Bill specifically prohibits an authorised representative of a financial services licensee from authorising another to represent them.

Disclosure and other conduct requirements for licensees

3.31 Part 7.7 prescribes the disclosure regime for financial services licensees and authorised representatives.

3.32 This disclosure regime encompasses a number of elements:

- Disclosure obligations will apply to financial service providers who provide services to retail clients.
- Financial service providers must give their retail clients a Financial Services Guide.
- Where personal advice is provided to a retail client that advice must have a reasonable basis. The provider must investigate the subject matter of the advice having regard to the client's objectives, financial situation and needs, and must base the advice on that investigation.
- The provider must give the client a Statement of Advice including the basis on which the advice was given and information about any conflicts of interest (including commissions, fee, or benefits) that the provider may have in giving the advice.
- The level of analysis undertaken and the issues that should be considered by the provider will vary depending on the complexity of the advice sought.
- Additional information must be included where the advice is to replace an existing financial product. This information must address the potential loss of any benefits and the costs associated with replacing the financial product.
- The client must be warned if the advice is based on information that is incomplete or inaccurate.
- Warnings must be provided to retail clients where general advice is provided.

3.33 Clause 941C in the current Bill corresponds to clause 911C in the exposure draft Bill. Clause 941C, however, has several extra parts which in effect obviate the

need to provide people with a Financial Services Guide where the financial service provided was simply general advice given in a public forum.

3.34 Without the new clause 941C it is possible that the practicality of print, radio and television journalists commenting on financial matters may have become unworkable because it is conceivable that the Bill could have been interpreted to mean that readers and listeners should be provided with Financial Services Guides.

Other provisions relating to conduct

3.35 Part 7.8, which was Part 7.7 in the exposure draft Bill, provides that licensees will be required:

- to establish and maintain a separate account in which to hold client funds (both retail and wholesale);
- to provide periodic statements to clients, where they hold funds or assets on behalf of clients;
- to keep financial records that correctly record and explain the transactions and the financial position of the financial services business carried on by the licensee;
- to prepare profit and loss statements and balance sheets and lodge them together with an auditor's report with ASIC;
- to give priority to clients' orders; and
- to disclose and obtain client consent when they will be acting on their own behalf in a transaction with a non-licensee.

Financial product disclosure

3.36 Financial product disclosure requirements and other requirements relating to the issue and sale of financial products form the subject matter of Part 7.9. This was Part 7.8 in the exposure draft Bill and, with a few technical variations, the approach adopted in the exposure draft has been retained.

3.37 This disclosure regime will replace a range of existing disclosure regimes for financial products, some legislative and some self-regulatory. The Bill provides for:

- point of sale disclosure through the giving of a Product Disclosure Statement (PDS);
- other disclosure obligations in relation to financial products encompassing:
    - ongoing disclosures; and
    - periodic reporting requirements;
- other obligations for transactions in relation to financial products covering:

    - handling money from applicants for financial products;
    - confirmation of transactions in relation to financial products; and
    - alternative dispute resolution mechanisms for product issuers;
- obligations with respect to advertising in relation to financial products; and
- cooling-off periods for certain financial products.

3.38 Part 7.9 will not replace the disclosure requirements for shares and debentures under the Corporations Law. However, some amendments will be necessary to the Corporations Law to take account of the new disclosure regime.

Market misconduct and other prohibited conduct

3.39 The Bill provides in Part 7.10 for the prohibition of market misconduct. This is a new section which was not included in the exposure draft Bill.

3.40 The provisions of Part 7.10 generally retain the form of the current provisions of the Corporations Law in respect of these matters but their scope has been extended, as appropriate, to apply to all financial products and markets.

3.41 A number of market misconduct provisions will become civil penalty provisions. This means that contraventions will be subject to both civil penalties and criminal consequences.

Title to securities and other matters

3.42 Parts 7.11 and 7.12 are technical sections dealing with matters relating to title to, and transfer of, certain securities and other financial products. Qualified privilege, the role of codes of conduct and the Minister's power to delegate are also covered.

Telephone monitoring during takeover bids

3.43 Among the other miscellaneous amendments which conclude the Bill is one that will insert a new section, clause 648J, into the *Corporations Act 2001*. It will require bidders and targets to record all telephone conversations with target shareholders during the bid period. Privacy safeguards to protect the information are also to be required.

3.44 The rationale for this is that it will provide greater protection for target shareholders, and enhance ASIC's capacity to investigate and take enforcement action in these situations.

Amendments

3.45 In a letter of 25 June 2001, the Minister for Financial Services and Regulation advised the Committee that he expected some amendments to be made to the Financial Services Reform Bill 2001 when it was debated in the House. Some amendments were made on 28 June 2001. The Department of the Treasury advised the

Committee that these amendments were the result of representations that both the Minister and Treasury had received. The substantive amendments are discussed below.

3.46 The amendments, among other things, provided an ‘explicit role’ for the Reserve Bank of Australia in relation to systemic risk issues associated with clearing and settlement facilities.

3.47 The exposure draft Bill had recognised the importance of systemic risk in relation to clearing and settlement facilities. It included as a general obligation the requirement to do all things reasonable to reduce systemic risk. The exposure draft Bill also anticipated a parallel licensing regime of clearing and settlement facilities of significance to the payment system. That regime would have been under the Payment Systems (Regulation) Act. However, the proposal for parallel licensing raised questions about the ultimate comparability of the two regimes.

3.48 According to advice from the Department of the Treasury, industry developments in Australia in the interval between the exposure draft Bill’s release and the introduction of the current Bill into the Parliament raised questions about the separability of the relevant clearing houses. It was thus deemed necessary to recognise the Reserve Bank’s role in relation to systemic risk in the payment systems generally.

3.49 Another of the recent amendments dealt with the power, under the original Bill, to make a regulation to exempt people from the financial service provider licensing provisions. This particular power ‘was just a straight exemption power to be made by regulations’.

3.50 As a result of representations the Government received, particularly from the media organisations, it was recognised that in certain circumstances it might be necessary to exempt people from the financial service provider licensing provisions, but subject to conditions. Thus people could be excluded from the licensing provisions, but could still be subject to a range of conditions. The original Bill was therefore amended so that it now contains a provision that enables any exemption from those licensing provisions to be subject to conditions.

3.51 Another amendment dealt with the licensing of natural person trustees, particularly in the context of superannuation funds. Representations were made to the Minister that the Bill was unclear as to whether each individual trustee had to be licensed or whether the group of trustees could be licensed. The view was also expressed that for some employer superannuation funds and the like it would be difficult for the trustees as individuals to satisfy the licence criteria.

3.52 The relevant amendment in effect creates a notional entity, namely the group of individual trustees, and allows the licensing of that notional entity, rather than requiring the licensing of each individual trustee.

3.53 The recent amendments also saw the licence obligation to act ‘competently and honestly’ in the original Bill replaced with an obligation to act ‘efficiently,

honestly and fairly'. This was in effect no more than a return to the current position in the Corporations Law.

3.54 Another amendment related to the respective roles of APRA and ASIC in relation to the licensing of APRA regulated bodies. In the original Bill there are provisions requiring ASIC to consult with APRA when it is making licence conditions, or varying, suspending or revoking the licence of an APRA regulated body. Concerns were raised about these provisions, in particular it was suggested that the requirements for compulsory consultation with APRA were a little broad.

3.55 There was a concern about APRA licences, for example, a bank's licence to conduct its banking business. ASIC licenses it to distribute those products. If ASIC revoked its distribution licence then it could not do the activities that APRA had licensed it to do. In a situation relating to the revocation of the licence, the revocation power is actually given to the Minister rather than to ASIC. In relation to other APRA regulated bodies such as super funds, there is a requirement for ASIC to consult with APRA before it does anything that can impact upon the activities for which APRA regulates the body.

3.56 The original consultation provisions have therefore been refined by the amendment to limit the consultation to situations where what ASIC is doing could have a significant impact upon the activities of the body which APRA regulates.

3.57 Another amendment dealt with the insider trading provisions. In the original Bill, the mental elements in all the offences had been made consistent with the Commonwealth Criminal Code. In relation to the insider trading provisions, that meant replacing a mental element of 'ought reasonably to know' with a mental element of 'recklessness'—because that is what the Criminal Code would have required.

3.58 As a result, however, of representations made following the introduction of the original Bill, concern has been raised that it might have meant raising the threshold of proof for that offence, thus the recent amendment returned to the mental element of 'ought reasonably to know'.

3.59 A ' technical amendment' to the definition of 'associate' was also made.

Possible Future Amendments

3.60 An additional amendment, still under consideration, relates to the telephone monitoring amendment discussed above, and the concerns that have been raised about the breadth of the amendment. The Minister has indicated that he intends to narrow the provisions relating to monitoring telephone calls, so that they apply only to retail shareholders. Calls involving, for example, institutional investors who do not need the same amount of protection as retail shareholders therefore would not be captured by the monitoring requirements.

3.61 A further possible amendment relates to the definition of 'basic deposit product'. Representations have been made to the effect that the element of the current definition that requires funds to be able to be withdrawn immediately raises particular concerns for smaller credit unions who have discretion as to whether their customers can withdraw their term deposits at any time. This is something that is still being considered.

3.62 Another issue raised with both the Committee and with the Minister is the definition of what is retail and what is wholesale in relation to superannuation products. The current Bill defines all superannuation products as retail products. A number of industry participants have pointed out that pooled superannuation trusts, which act for other superannuation funds, should not be required to meet the disclosure provisions in the Bill designed for retail products. This matter is still under consideration.

Timing and Transitional Arrangements

3.63 On 7 June 2001 the Financial Services Reform (Consequential Provisions) Bill 2001 was introduced into the House of Representatives. The Bill passed the House on 28 June 2001. This Bill makes provision for the transition to the regulatory regime proposed by the Financial Services Reform Bill. It also makes a range of amendments to other legislation, which are necessary as a consequence of the Financial Services Reform Bill.

3.64 The transitional provisions in the (Consequential Provisions) Bill are of two types: those that deal with when the financial services reform regime begins to apply to different people, and those that deal with how a person moves from their existing regulatory regime into the financial services reform regime.

3.65 Generally, the (Consequential Provisions) Bill allows for the provisions in the Financial Services Reform Bill to be phased in over two years.

3.66 On 5 April 2001 the Minister indicated that, to allow sufficient time to consult on the regulations to be made under the Bill and to enable the Australian Securities and Investments Commission and industry to gear up for commencement, he now proposed to start the two year transition period from 1 October 2001.

3.67 The transitional arrangements for financial service providers and financial products, however, will ensure that this commencement date of 1 October 2001 will simply give those existing participants who are ready on that date the opportunity to comply if they so wish. Others who need more time to prepare will generally have up to 1 October 2003 to comply with the requirements of the Financial Services Reform Bill.

3.68 This will enable those financial service providers and product issuers who are ready by 1 October this year to take advantage of the efficiencies offered by the new regulatory regime at the earliest possible time, while not forcing an unrealistic commencement date on those who need more time.

CHAPTER 4

SUPPORT FOR THE BILL AND PROCESS ISSUES

Introduction

4.1 At hearings in Sydney on 13 June 2001, the Chief Executive Officer of the Investment and Financial Services Association (IFSA), Miss Lynn Ralph, told the Committee that the Bill is both important and 'unusual' in that it does not address any failure in the market or in the financial system. Instead it is: 'about looking forward and about trying to ensure that we had a regime that would enable our industry and our consumers to thrive over the next couple of decades'.[1]

4.2 This objective however, along with the comprehensive nature of the Bill, has meant that although the legislation has been generally endorsed aspects of the proposed reforms have been perceived by some industry sectors as unnecessary, or having unintended (and negative) effects. The Committee's inquiry has acted as a conduit for the community's response to the Bill; enabling Committee members to gauge the overall degree of understanding or acceptance of the reforms, and to identify any unintended consequences of the legislation as drafted at present.

4.3 As a preliminary to detailed analysis of policy and drafting issues covered in the following chapter, this section of the report first records industry's general support for the Bill. It then surveys concerns raised about the introduction of the legislation, including the proposed timeframe of the Bill, about ASIC's consultation with industry, and its role in interpreting and implementing the regime after its intended introduction on 1 October 2001.

Support for the Bill

4.4 The Financial Services Bill 2001 has been well received by the financial services industry. To gain this degree of acceptance the legislation has undergone significant refinements since the reforms were suggested by the findings of the Financial System Inquiry in the Wallis report in 1997. The process has involved extensive consultation between Government, representative bodies and participants in the financial services sector.

4.5 A majority of key stakeholders making submission to the inquiry was satisfied with the main objectives of the Bill: the introduction of single licensing and standardised disclosure regimes for financial service providers. Many of these stakeholders, having previously contributed to the Committee's inquiry into the draft Financial Services Reform Bill, also expressed satisfaction that matters raised in

---

1 Committee Hansard, p. 121.

regard to the exposure draft had been fully, or in some measure, addressed in the present legislation.

4.6 The Investment and Financial Services Association (IFSA), for example, strongly supported the reforms and welcomed the Bill as ‘both well conceived and executed’. IFSA noted as significant improvements on the draft legislation the clarification of the definitions of ‘advice’ and ‘dealing’; and of the application of the objective test for ‘personal advice’, which it considers will add certainty and result in a ‘fairer and more realistic licensing regime’. IFSA also considers that the new disclosure regime, as amended, should realise the Bill’s objectives if it remains consistent in application.[2]

4.7 The Australian Association of Permanent Building Societies saw that amendments to the Bill would address problems for rural and regional service providers raised by the draft Bill. These amendments included the exclusion of cashier and clerical duties from the definition of financial services; the exclusion of the interpretation of information from the scope of financial product advice; and the apparent realignment of training requirements for staff and agents of a licensee to match duty levels. Overall, the Association judged that the changes would sustain the present level of services in non-metropolitan areas.[3]

4.8 The International Banks and Securities Association of Australia (IBSA) endorsed the Government’s initiatives for an integrated licensing system, believing it would establish a sound and efficient regulatory regime for investment banks and securities.[4] The Australian Financial Markets Association (AFMA), in a joint submission with the Securities and Derivatives Industry Association, welcomed, in particular, refinements to the definition of financial advice and the inclusion of that of professional investor.[5] The Australian Payments Clearing Association was satisfied that its submission to the draft Bill had been addressed, in that its clearing systems would now be exempted from the licensing regime by definition in the Bill.[6]

4.9 At hearings in Melbourne on 27 April 2001, the Insurance Council of Australia (ICA) applauded the ‘extensive consultation’ it had enjoyed with Government in the drafting phase of the Bill. The ICA reported that most of its recommendations on the draft Bill have been incorporated in the present legislation, and commended the flexibility of the resulting disclosure regime. The Council also welcomed the key definitions of the Bill, and particularly the definition of ‘personal advice’.[7]

2 Submission no. 29, pp. 1–2.

3 Submission no. 8.

4 Supplementary submission no. 24A, p. 1.

5 Submission no. 34, p. 2.

6 See Submission no. 30, p. 1

7 Committee Hansard, p. 27.

4.10 Major insurance groups such as NRMA Insurance Limited and AMP Limited strongly supported the broad policy objectives of the Bill.[8] In its submission, AMP described the Bill as a 'significant milestone in the process of financial services and industry reform' and urged its speedy passage.[9] The HCF Life Insurance Company also welcomed changes to licensing requirements, which will allow an employee of a 'related body corporate' to provide a financial service, thus addressing the concerns of conglomerates.[10]

4.11 The Australian Superannuation Funds of Australia (ASFA) agreed that the Bill's 'establishment of a clear and consistent licensing regime will benefit consumers and industry alike'. ASFA also noted that there is a greater recognition in the Bill of the nature of superannuation within the Australian retirement system and of the existing regulatory requirements set out in the *Superannuation Industry (Supervision) Act 1993*.[11] In this regard, Comsuper, the administrator of the Commonwealth and defence force public sector superannuation schemes, wrote that the Bill clarifies concerns about licensing and disclosure requirements for these schemes which had been unclear in the draft legislation.[12]

4.12 The Australian Consumers Association (ACA) and the Financial Services Consumer Policy Centre supported the overall concept of the Bill, noting that the consumer movement has been anticipating the Bill as a new foundation for provision of consumer protection in financial services.[13] Their views were endorsed by the Consumer Law Centre of Victoria.[14]

4.13 Finally, the Chartered Secretaries Australia (CSA), a peak body for corporate governance, supported the general thrust of the legislation and applauded, in particular, the inclusion of the cooling off period and, through the setting of minimum standards, the self-regulatory emphasis which it considered should reduce litigation.[15]

Concerns about the process

4.14 Despite this overall positive response, however, a number of stakeholders observed that they could not unconditionally support the legislation because its operation could not be fully known until the Australian Securities and Investments Commission (ASIC) released its policy papers, and the regulations supporting the Bill were finalised by the Department of the Treasury.

---

8 Submission nos 25 and 49.

9 Submission no. 49, p. 1.

10 Submission no. 39, p. 1.

11 Submission no. 16, pp. 3, 7.

12 Submission no. 53, p. 1.

13 Submission no. 44, p. 1, and Submission no. 37, p. 2.

14 Submission no. 46.

15 Submission no. 65, pp. 2, 3.

4.15 During the inquiry, some industry representatives protested that the tight timeframe allowed for finalising the actual legislation and the regulations will not allow affected sectors to participate fully in the drafting processes, and so to address deficiencies, inconsistencies or ambiguities in the legislation which may cause problems later. They were also concerned that lack of detail in the legislation might give too great a degree of responsibility to ASIC for its interpretation, resulting in reduced certainty for particular industry sectors.

4.16 This section of the report considers ASIC's role in overseeing the Bill's progression and raises issues about consultation and timing, including the proposed transitional arrangements for introduction of the licensing regime.

ASIC: administrator and regulator of financial reform

4.17 Under the new legislation, ASIC will act as administrator and regulator of financial services reform. It will offer guidance to industry to interpret the legislation and its accompanying regulations, providing advice about the licensing and disclosure requirements and monitoring the industry's compliance with these. Within this, it is also charged to adjudicate the status of certain exemptions such as that for 'declared professional bodies' and also to collaborate with other bodies such as the Australian Prudential Regulatory Authority (APRA), for example, where it is considering attaching conditions to deposit taking institutions.

4.18 At the same time, under the new regime, the onus will be on the financial services sector to establish the guidelines and internal mechanisms necessary to qualify for, and maintain, the appropriate type of financial service licence. Industry will also be required to self assess its licensing requirements and to apply for a licence that is appropriate to the type of service the business provides. The reformed system is intended to provide consumers with greater certainty, encouraging them to participate in the domestic financial services sector as a platform for Australia as an international financial services centre.

4.19 As the Department of the Treasury has stated, the aim of the legislation is to develop the broad framework of reform, with the accompanying regulations and interpretative guidelines prepared by ASIC giving flesh to the regime.[16] The inquiry revealed that this combination of oversight by ASIC and self-regulation has generated a degree of concern among industry participants, who believe that the legislation does not provide the certainty necessary for industry to meet the various challenges required for compliance.

Role of the regulations

4.20 A number of submitters were concerned about the role that the regulations, at present being drafted by the Department of the Treasury, will have in determining outcomes for their industry sectors. They saw too, that to leave the details out of the

---

16 Committee Hansard, p. 268.

legislation meant ASIC would have more power in interpreting or varying the effect of the regulations. To some submitters this meant increased potential for difference of interpretation, by both industry and ASIC, of the legislation creating even greater uncertainty and the potential for unintended breaches of the requirements.

4.21 Representatives of the Institute of Chartered Accountants in Australia and CPA Australia, for example, reported that they were uncomfortable that important definitions, such as that of 'class of products', are not addressed in the legislation but are instead defined by ASIC in a policy paper.[17] Mr Stan Droder of CPA Australia observed that ASIC had interpreted the definition of incidental advice in a very wide way, raising industry concerns about clarity.[18]

4.22 The National Institute of Accountants (NIA) was concerned about the great degree of power awarded ASIC in determining the status of declared professional bodies under the legislation. NIA noted that while, in this case, the Bill is clear in articulating the criteria, equal clarity is needed in the regulations to avoid both failure to gain the exemption and unintended breaches.[19] It concluded that, in the end, the quality of the regulations would decide ASIC's effectiveness in achieving this goal:

> The regulations that will go with the new reforms…need to be clear, unbiased and effective. This requires the industry is clear on when a licence is needed, what sort of licence is required, who is covered by the regime. The regulations must be clear on what the outcomes will be and how the operators will be affected.[20]

4.23 Meanwhile, the Chartered Secretaries Association (CSA) saw value in ASIC's role in interpreting and finetuning the regulations. It judged that, in the interests of flexibility, it is preferable to vary product definitions, and what constitutes certain products, by regulation rather than changes to the Act. At the same time, the CSA emphasised that the process must involve 'constant consultation' with stakeholders to ensure that there would be no unintended consequences stemming from variations.[21]

ASIC's policy proposal papers (PPP)

4.24 For its part, ASIC has sought to reassure industry by announcing that, as regulator, it will aim to set 'clear and objective minimum standards', not only to facilitate the licensing process, but also to establish a baseline for compliance by all licensees, product issuers and others with obligations under the Bill.[22]

---

17 Committee Hansard, p. 42.

18 Committee Hansard, p. 42.

19 Submission no. 48, pp. 5–6.

20 Submission no. 48, p. 17.

21 Submission no. 65, p. 4.

22 *Building the FSRB Administrative Framework, Policy to Implement the Financial Services Reform Bill 2001*, p. 7.

4.25 To support the process, ASIC has made commitments to provide 'upfront guidance' in the form of policy publications, process guidelines, licence application kits and 'Question and Answer' documents. In late May 2001 ASIC also commenced a sequence of public briefings nationwide to explain transitional arrangements to industry in the lead up to the planned introduction of the new regime on 1 October 2001.[23]

4.26 In the implementation paper for the Bill, ASIC included a proposed time frame for the release of policy related documents.[24] The timeframe indicated that the papers would be released in three phases: policy papers in April; draft interim policy statements in June; and final policy statements in September/October 2001.[25]

4.27 ASIC's preliminary policy statements for the Bill were released on 25 April 2001. They comprised five policy proposal papers addressing licensing and disclosure issues, an implementation paper and a process guideline paper describing how to get an Australian financial service licence.[26] A second tranche of four policy proposal papers, numbers six to nine, were issued on 6 June 2001 as planned. These addressed licensing issues relating to principals and representatives, external and internal dispute resolution procedures, ASIC's discretionary powers and a paper on approval of codes.

4.28 At hearings on 27 June ASIC's representatives explained the organisation's position on its policy statements and their purpose in providing guidance for administration and interpretation of the legalisation. Mr Ian Johnston, Executive Director of Financial Services Regulation, stated:

> Our policy proposal papers are designed to raise the issues in terms of how we will apply the provisions of the law. It is not our role to frame the legislation or the policy which drives it: that is for others to consider. Nor is it ASIC's role to clarify what policy is in this area. I believe that the Department of the Treasury has appeared before the committee today for that purpose.[27]

4.29 Mr Shane Tregillis, Executive Director, Policy and Markets Regulation, further clarified that:

> The main aim of a policy statement is not to explain or deal with particular circumstances of fact but largely to set out the underlying principles… Policy statements are also important because most of the decisions here are

23 *Building the FSRB Administrative Framework, Policy to Implement the Financial Services Reform Bill 2001*, p. 7.

24 See Table E, *Building the FSRB Administrative Framework, Policy to Implement the Financial Services Reform Bill 2001*, p. 31.

25 'Policy Proposal and Process Papers for the FSR Bill', *Media Release* 01/ 135, Australian Securities and Investment Commission (ASIC), 26 April 2001, pp. 1–2.

26 'Policy Proposal and Process Papers for the FSR Bill', pp. 1–2.

27 Committee Hansard, p. 309.

> reviewable by AAT [Administrative Appeals Tribunal], so the AAT does pay attention to an agency's policy position when it does a review. It is important to have a soundly based policy when you are exercising discretions—the grant of a licence, refusal of a licence, such exercise of a discretion. So that is really their function. It is not to write the law.[28]

4.30 Mr Tregillis also advised that policy statements are quite separate to any discretionary powers, where ASIC has formal exemption powers to modify the law under a class instrument where required. Instead, the policy papers are designed to be 'consultative' documents; to give information and solicit feedback so that ASIC can take the right administrative and policy path.[29]

Timing and consultation

4.31 On the release of the first set of policy papers, the Deputy Chair of ASIC, Jillian Segal, announced a six week period of consultation with industry over the legislation as defined in the policy papers. Written submissions were also invited. ASIC also stated that it would set up a consultation process to settle supporting regulations.[30] Even so, industry's response to the process early in the inquiry was not completely positive.

4.32 At the Committee's hearing in Melbourne on 27 April, the Institute of Chartered Accountants in Australia and CPA Australia queried the feasibility of such consultation occurring within the given time frame. The Institute's Technical Adviser, Mr Keith Reilly, also informed the Committee that the Institute and CPA Australia had not had the opportunity to discuss the present Bill with Treasury or ASIC prior to its being tabled in Parliament.[31]

4.33 The Association of Superannuation Funds of Australia (ASFA) noted that the present legislation appears to be more reliant on interpretation in the regulations than was the case in the draft Bill. It submitted that a lengthier process of consultation—between the Government and industry, and between Treasury and ASIC—over both the Bill and the regulations was therefore important.[32]

4.34 There was agreement among a range of key stakeholders, such as the Association of Superannuation Funds of Australia Ltd (ASFA), IBSA, and the NRMA, that the timeframe proposed for public assessment of the Bill was not sufficient and all requested extended time for consultation.

---

28 Committee Hansard, pp. 311–12.

29 Committee Hansard, p. 312.

30 'Policy Proposal and Process Papers for the FSR Bill', p. 1.

31 Committee Hansard, p. 40.

32 Submission no. 16, p. 11.

4.35 At an 'ASIC Speaks: on the FSR Bill' industry briefing in Melbourne on 25 May 2001, ASIC acknowledged that the timeframe for consultation was necessarily short due to the need to progress the Bill by 1st October. In answer to questions, however, ASIC's representatives reassured industry that consultations between Treasury and ASIC were both regular and in depth and would be ongoing. [33]

4.36 On 14 June 2001, at the Committee's meeting with ASIC under its statutory oversight obligations, Ms Jillian Segal, Deputy Chair of ASIC, was able to report the success of the consultation process:

> …we have received lots of feedback that people do value that process. It is a transparent process. We go out there with draft policies or policy proposals and seek comment—and not only written comment: we have meetings, round tables and workshops—and try to understand the issues that a particular policy raises for business and then translate that into a final policy. People have particularly commented on the process itself being an excellent one in trying to reach people, to understand and to seek information so that we can then base policy on an understanding of business.[34]

4.37 During the hearing on the 27 June 2001, ASIC representatives further reported that, since issuing the PPPs, some 30 meetings had been held with industry and consumer groups to discuss issues raised in the papers. A second round of meetings would be held to consider issues arising from the second tranche of policy papers issued in June. ASIC also advised that some 2 500 people had attended 'ASIC Speaks' seminars nationally and that some 1 800 people had registered for e-mail advice. In addition, some fifty submissions had been received on various issues arising from the policy papers.[35]

4.38 However, the Committee wished to investigate how ASIC was dealing with some of the operational challenges posed by the timeframe set for the Bill, and what implications might arise for industry from these.

4.39 A number of witnesses, for example, remarked on the amount of work involved in sifting through the legislation, and ASIC interpretations, to identify issues that would affect them. At the FSRB hearings on 14 June, ASFA reported, for instance:

> …we are trying to deal with over 1 200 pages of documentation on the Financial Services Reform Bill. It has not ended. At the end of this process we are going to have probably close to 2 000 pages of FSR bill, explanatory

---

33 Mayfair Room, Grand Hyatt Hotel, Collins Street, Melbourne.

34 Statutory Oversight of ASIC, Committee Hansard, p. 96.

35 Committee Hansard, p. 309.

> memorandum and policy proposal papers from ASIC, and we have not even seen the regs yet. [36]

4.40 ASIC reported that its contribution so far had been somewhat less than 600 pages.[37] Mr Johnston emphasised that ASIC had canvassed industry to determine which issues it wished addressed first, and papers were released for discussion according to identified need. He stated that resource limitations had also dictated this approach. [38]

4.41 At the hearings, relating to the Committee's statutory oversight of ASIC, Chairman Mr David Knott also reiterated that the organisation is under 'resource pressure' and hoped that a pricing review to be conducted by the Department of Finance in the second half the year would recognise that the 'changed' circumstances (presumably, overseeing the financial reform regime) would merit additional funding.[39]

4.42 Another concern to the Committee was coordination of ASIC's policy advice with the regulations, being prepared by the Department of the Treasury. Asked about the difficulties of preparing policy papers without the benefit of seeing the regulations, Mr Tregillis explained that, in its implementation document for the Bill, ASIC has an 'explicit statement that we will review all of these policies in the light of the regulations and the final Bill as passed by Parliament'.[40] He also advised that ASIC had chosen to focus on issues which were less dependent on additional regulation, although cognisant that the legislation may change through regulation and the parliamentary process, and that ASIC's final policies must reflect that change.[41]

Transitional licensing arrangements

4.43 Another significant concern for industry participants arising around the timeframe for the Bill's implementation related to the proposed transitional arrangements, especially given the new regime's self-regulatory emphasis.

4.44 At the 'ASIC Speaks' briefing referred to above, ASIC took the opportunity to highlight the self-regulatory aspect of the reforms, showing that its expectations of industry to meet the changes indicated by the Bill are high. In its administrative policy implementation paper, ASIC also emphasised that compliance 'is the responsibility of the regulated entity' and that all affected parties must put in place 'adequate measures,

36 Committee Hansard, p. 198.

37 Committee Hansard, p. 110.

38 Committee Hansard, p. 310.

39 Statutory Oversight of ASIC, Committee Hansard, p. 63.

40 Committee Hansard, p. 323.

41 Committee Hansard, p. 322.

processes and procedures to comply with its obligations under the Law (as amended by the Bill)'.[42]

4.45 ASIC advised financial industry operators that they must plan ahead to facilitate smooth transition and manage compliance with the new legislative framework. In addition, professional and industry associations were reminded of the new role they must play in assisting members to manage transition and monitor their compliance with the new framework. These entities are to keep up to date with the progress of the legislation and, when the time comes, to fully comply with ASIC's information requirements to progress the new licensing regime.[43]

4.46 Ms Pamela Vamos, Financial Services Reform Policy Coordinator, alerted industry to ASIC's proposed timetable for release of policy and process documents included in the policy implementation program. She invited industry participants to e-mail the Project Office with any comments or questions about the new regime, and explained that ASIC had adopted the electronic system for licensing as part of its policy platform to make the implementation phase of the licensing regime more efficient. Ms Vamos reported, however, that the Project Office is at present staffed only by two: herself and another officer.

4.47 Submissions to the inquiry indicated there is a degree of unease about ASIC's expectations that industry can meet requirements, including the establishment of mechanisms for self-regulation, within the expected timeframe. For instance, representatives from a number of industry sectors wrote asking for clarification, or a broader application, of the transitional licensing arrangements, as announced by Minister Hockey in his press release on 5 April 2001.[44]

4.48 Submissions from the Australian Superannuation Industry Association (ASFA), the International Banks and Securities Association (IBSA), the Credit Union Services Corporation (Australia) Limited (CUSCAL) and Mallesons Stephen Jaques, Solicitors, all requested that consideration of specific industry concerns should be taken into account when designing the transitional licensing provisions, and that transitional arrangements should apply to some industry participants not currently required to hold licences.[45]

4.49 In its submission, ASFA asked for clarification of the status of currently regulated, complying super fund trustees under the transitional licensing arrangements, noting that lack of clarity on this important matter has the potential to

---

42 *Building the FSRB Administrative Framework, Policy to Implement the Financial Services Reform Bill 2001*, p. 8.

43 *Building the FSRB Administrative Framework, Policy to Implement the Financial Services Reform Bill 2001*, p. 8.

44 'Hockey Introduces Financial Services Reform Bill', Minister for Financial Services and Regulation, *Press Release* no.SR/025, 5 April 2001.

45 Submission nos 16, 24, 18 and 35.

throw the entire superannuation industry into turmoil.[46] ASFA asked that APRA-regulated super fund trustees should be treated as 'existing licensees' in a similar manner to 'approved trustees' of public offer superannuation under the new regime, so they can apply for a financial services licence to cover existing activities through the making of a declaration.[47]

4.50 IBSA asked for clarification of the arrangements for existing custodial businesses. IBSA recommended that the forthcoming Financial Services Reform (Consequential and Transitional Provisions) Bill should contain a provision allowing for existing custodial businesses to qualify for the two-year period to apply for and obtain a license under the new regime.[48]

4.51 CUSCAL approved the proposal for new product issuers to opt in to the new regime at any time during the transitional period. CUSCAL noted that credit unions will need the full transitional period to train staff, to develop new compliance systems and disclosure documents, and to use the current stock of documents.[49]

4.52 Mallesons Stephen Jaques requested transitional relief for derivatives dealers and market makers. The firm is concerned that if transitional relief is limited only to products previously licensed, a number of market participants will have to apply for a licence for other aspects of their business, particularly as the wide definition of derivative in the legislation will catch transactions such as futures sales of securities, often carried out by securities licensees.[50]

4.53 Finally, Ms Louise Petschler, Senior Policy Officer of the Australian Consumers Association, stated that consumer groups would like to see that the transitional arrangements applied for as short a period as possible, so that full conduct and competency requirements would apply. She expressed a particular concern that life agents would be allowed a two year transitional period to comply.[51]

4.54 On 7 June the Financial Services Reform (Consequential Provisions) Bill 2001 was introduced into the House of Representatives. The Explanatory Memorandum for the Bill advised that the transitional provisions are divided into two different categories. These are: 'phase in' provisions, relating to industry sectors not currently regulated; and, provisions for those already regulated but moving under

46 Submission no. 16, p. 9.

47 Submission no. 16, p. 10.

48 Submission no. 24, p. 1.

49 Submission no. 18, p. 3.

50 Submission no. 35, p. 2.

51 Committee Hansard, p. 59.

regulation by the FSR regime. These last are dealt with by providing regulation making powers and powers for ASIC to make appropriate rules.[52]

4.55 However, again, industry response to transitional arrangements announced in the Consequential Provisions Bill was not entirely positive. In Sydney, on 14 June, Dr Michaela Anderson, Director of ASFA, told the Committee that the Consequential Provisions Bill 'raised more questions than it has answered' in relation to the transitional period for superannuation funds, particularly in regard to licensing.[53]

4.56 Ms Karen Hamilton of the Australian Stock Exchange reported that the complexity of the transitional arrangements made it difficult to ascertain their full effect. She concluded, however, that while the transitional arrangements seemed at first beneficial, she judged that they would only apply to businesses 'set in stone', and that any innovator looking to embrace new business activities would not be covered.[54]

4.57 Mr Con Hristodoulidis of the Financial Planning Association criticised the proposed 'qualified licences' for multi-agents, under the 'phase in' provisions of the legislation. He advised that the proposed arrangement, which allowed multi-agents a 15 to 18 month period to comply with training and other requirements, works against the objective of establishing unified standards across the entire financial services industry and concluded that 'the measure as it currently stands diminishes consumer protection'.[55]

---

52 Financial Services Reform (Consequential Provisions) Bill 2001, Explanatory Memorandum, Commonwealth of the Parliament, House of Representatives.

53 Committee Hansard, p. 191.

54 Committee Hansard, p. 233.

55 Committee Hansard, p. 157.

CHAPTER 5

POLICY ISSUES RAISED BY THE BILL

Introduction

5.1 As recorded in the previous chapter, the key objectives of the Financial Services Reform Bill 2001—to benefit the consumer through introduction of a single licensing and standardised disclosure regime for the financial services sector—has the overall support of consumer representatives and industry stakeholders. At the same time, however, their evidence to the Committee was that the Bill may have some unintended or adverse consequences for particular industry sectors or for consumers.

5.2 Some of the issues identified by industry and consumer groups were the same as, or permutations of, those identified in the Committee's report on the draft Bill. Others, such as the provisions on the recording of some telephone conversations during takeovers and the repeal of Corporations Law exemptions for journalists from licensing requirements, were entirely new to the legislation.

5.3 While these last matters prompted requests for significant amendments to the legislation, most of the recommendations made to the Committee require only minor modification of the Bill, or suggest a need for clarification in the regulations. This chapter of the report provides an overview and an analysis of industry, advisory body and consumer response to the Bill.

Overview of issues raised

5.4 Despite acknowledged improvements over the draft Bill, a majority of submissions called for still finer definition of key terms within the legislation—of the meaning of financial products, of financial advice, and for more specific information about disclosure and licensing requirements arising out of these definitions.

5.5 Many criticisms of the Bill were anchored in the technical and practical implications of its aspects for particular industry sectors. Small businesses in the life insurance industry, for example, continued to express concerns that commission disclosure requirements, coupled with the new single licensing arrangements, would affect their viability. The telephone disclosure requirements were a problem for the travel, health and motor vehicle insurance industries which use telephone, or call centres, as their main means of product promotion.

5.6 There were also a number concerns in relation to the Bill's regulation of the superannuation industry, with potential unintended consequences of the threshold set for the 'product value test' for some superannuants, and the classification of pooled superannuation trusts (PSTs) as retail, indicating to some submitters a 'serious flaw' in the legislation. Training requirements to provide financial advice remained a key concern to industry and consumer groups generally, and particularly for

superannuation board trustees and for some long term insurance industry members who took their training prior to 1995. The Committee also heard that the present drafting of the Bill does not take into account the situation of corporate and industry superannuation funds which had previously been treated separately as 'not-for-profit' funds under the *Superannuation Industry (Supervision) Act 1993* [the SIS Act].

5.7 Uncertainties about the licensing regime focussed on definition of exemptions and authorisation issues. Lawyers and accountants were concerned about the breadth and operation of exemptions for the giving of incidental advice. The implications of the proposed licensing regime for foreign companies providing financial services within Australia also attracted comment, with the Australian Stock Exchange (ASX) suggesting that the Bill would not consolidate Australia's status as a centre for international financial services as intended.

5.8 Meanwhile, consumer groups judged that while the regime was ostensibly aimed at gaining the confidence of, and benefiting consumers, a number of aspects of the Bill did not appear to be drafted with the consumer's good in mind. In particular, these groups contested proposed exemptions from requirements under the disclosure and licensing regimes, and so opposed requests made by some industry groups to extend the application of these exemptions.

5.9 Another group of submitters proposed that the disclosure regime could be used to promote the growth of the ethical investment in Australia. These submitters stated that this was an important issue for Australian consumers who, surveys had shown, supported developments in this area.

5.10 The Bill also introduced two new proposals relating to telephone recording of shareholder canvassing during takeover bids and regulation arrangements for financial reporters, through the repealing of the media exemption in the Corporations Law. These attracted particular criticism for being framed without consultation with relevant industry participants. In response to this criticism, and practical issues identified, the Government announced that it would modify the legislation by amendment or regulation.

Revoking of the media exemption

Introduction

5.11 At present the reporting of financial matters by the media is exempted from licensing requirements under section 77 of the Corporations Law, if the investment advice is offered in a newspaper or periodical which is available without subscription. The exemption does not apply to publications with the principal purpose of offering investment advice about securities or of providing securities reports. The scope of the exemption is described and supported by ASIC's Policy Statement PS 118. The effect of the provision is to provide a wide-ranging exemption to media organisations from the licensing and associated provisions in Chapters 7 and 8 of the Corporations Law, apart from those relating to registers of interests in securities.

5.12 The Bill proposes the repeal of the exemption so as to bring all providers of financial advice under the same regulatory and disclosure regime. As the Department of the Treasury explained, the fundamental basis of the Bill is the imposition of a unified regulatory regime based on generalised principles that apply across the financial services industry without any detailed application to any particular sector. The revoking of the media exemption was, therefore, incidental to the 'philosophy' of the new regime as drafted, and so redundant under its operation.[1]

5.13 However, the removal of the exemption alarmed Australia's media community. It reported a lack of consultation about the proposed changes and saw deep conceptual and practical problems arising for the media under the new regime. Organisations also noted that the Explanatory Memorandum to the Bill made no particular mention of the revoking of the media exemption, or reference to the regime's intentions towards the media.

5.14 The Committee received submissions from key stakeholders in the Australian newspaper and broadcasting industry, both private and public sector, and also from Reuters, the UK-based international press agency, outlining these concerns. In recognition of the degree of unease about the legislation, the Committee invited representatives from Fairfax Holdings Limited, News Limited and from the Federation of Australian Commercial Television Stations and the Special Broadcasting Service (SBS) to give evidence in Sydney on 13 June 2001.

Ethical and international implications

5.15 For media organisations, the removal of the exemption under the Corporations Law was not a necessary or appropriate consequence of financial and regulatory reform. Fairfax Holdings Limited and News Limited noted that the Wallis inquiry had made no recommendations in this regard and that ASIC, commenting in its policy statement on section 77 in January 2000, had stated that it 'did not see any net regulatory benefit' in seeking law reform to remove the exemption.[2] Fairfax, News Limited, the SBS and the Australian Press Council all agued that there is no need for change as the current framework works well with no record of complaint from consumers.[3]

5.16 An underlying concern for media representatives was that the Bill, in setting up a regulatory regime to protect consumers against misleading advice, may actually counter that aim by limiting the freedom of the press to fully inform the public about financial products and services. In this regard, they argued, the Bill contradicts the guiding principal of freedom of information in a democracy, where the key role of the media is to provide readers with a range of viewpoints supplemented by factual analysis so that they might form their own conclusions.

---

1 Committee Hansard, p. 268.

2 Submission no. 62, p. 3, and Submission no. 70, p. 7.

3 Submission nos 62, p. 2; 70, p. 3; 80, p. 3; 74, p. 1.

5.17 At hearings, Mr Bruce Wolpe of Fairfax stated that, in revoking the exemption, the Bill takes Australia into 'dangerous territory', where the fundamental integrity of press freedom is no longer preserved by statute. He asserted that this was 'an irreparable step backward' for the protection of journalism—and hence the consumer's right to be informed—in Australia. News Limited's Mr Warren Beeby added that without a constitutional commitment to freedom of speech or a Bill of Rights the exemption provides the only certainty for the media.[4]

5.18 These views were widely endorsed by other media organisations, with SBS also noting that the Bill would compromise its editorial independence, as established by the SBS Act, through subjecting SBS programming and editorial decisions to a government licensing regime.[5]

5.19 Reuters further pointed out that Australia would be alone in the world if it chooses to subject its media to licensing and supervision by a financial services regulator. It noted that the UK, in implementing a financial regulatory reform program recently, had retained an express statutory exemption for the media from the UK's investment advice regime.[6] At hearings, News Limited's Mr Beeby told the Committee that he understood that similar exemptions also applied in the United States, in Canada, New Zealand, Hong Kong and Singapore.[7]

5.20 Reuters also advised that, in pursuing the current proposal, Australia would contravene its commitments to the World Trade Organisation's General Agreement on Trade in Services—GATS. Under GATS, Australia must not impose limitations or restrictions on market opportunities or existing benefits to financial service industry participants such as suppliers of financial information services.[8]

5.21 In this regard, the Federation of Australian Commercial Television Stations (FACTS) and the Australian Subscription Television and Radio Association (ASTRA) warned that the requirements would affect Australia's competitiveness as a hub for international financial activity. The organisations identified a number of operational hurdles which they predict will act as disincentives for broadcasters to research and report on Australian markets, driving down both the amount and the quality of information available to the consumer.[9]

---

4 Committee Hansard, p. 171.

5 See News Limited Submission no. 70, p. 5; Australian Press Council Submission no. 74, p. 1; Broadcasters Submission no. 79; and SBS Corporation Submission no. 80, pp. 2–3.

6 Submission no. 71, p. 1. On request of the Committee, Fairfax tabled a copy of the wording of the exemption on 13 June 2001; see Committee Hansard, p. 172.

7 Committee Hansard, p. 187.

8 Submission no. 71, p. 3.

9 Submission no. 79, p. 4.

5.22 Alternatively, News Limited predicted Australian news provision will become less competitive with overseas providers who will probably, due to difficulty of enforcement, escape the regime.[10]

Operational concerns

5.23 Concerns about the media's ability to deliver accustomed services after the implementation of the Bill are anchored in the uncertainties raised by the Bill's definition of financial advice and how the proposed vetting by ASIC of information could feasibly work in a busy news environment.

5.24 At hearings in Canberra on 27 June 2001, Ms Sue Vroombout, Manager of the Product Disclosure Unit, Financial Markets Division, the Department of the Treasury, told the Committee that the status of media providers hinges on the Bill's definition of financial advice. She advised that if a representative of a media organisation offers general financial advice—that is, makes a value judgment about a particular product, in the course of doing business—then the provider would be caught by the requirements and should take steps to comply.[11] The options would include the organisation taking out a license and having their journalists authorised, or the journalists themselves being licensed.[12]

5.25 Media organisations were satisfied with requirements that those in the media who are being remunerated for giving financial advice should be licensed, as is presently required, but they saw real difficulties emerging in the 'grey areas'. These are where journalists are reporting the opinions of, or are interviewing, other experts, or indeed any public figure who might express a view that could be read as influencing the audience.

5.26 Reuters noted that, under policy advice from ASIC, the media would have to monitor every journalist or article on a case by case basis to ascertain whether or not the newsmaking would fall within the requirements of the licensing regime.[13] News Limited saw that ASIC's task will not be easy, as the distinction between 'fact' and 'opinion' in a media context will be difficult to make and administer, especially given the journalistic process of quoting advice from others.[14]

5.27 In this context, SBS forecast a nightmare scenario where advice would potentially have to be sought from ASIC about the status of any program (even non-business programs) produced in 68 languages by 68 separate presenters to determine whether it might breach the regulations.[15] Reuters concluded that the regime will

10 Submission no. 70, p. 7.

11 Committee Hansard, p. 268.

12 Committee Hansard, p. 269.

13 Submission no. 71, p. 2.

14 Submission no. 70, p. 5.

15 Committee Hansard, p. 176–77.

cause 'immense practical difficulties' for news organisations which have clients who rely upon the reporting of market sensitive developments with the greatest possible speed and accuracy.[16]

5.28 A key issue for the media arising from this is whether or not journalists and presenters will be exposed to an increased possibility of criminal action because of the difficulties of ascertaining whether or not they, or their employers, will be required to be licensed to carry out their professions. Media organisations pointed out that the type of regulatory regime proposed is unnecessary as the media have their own well-established editorial guidelines which require, for example, disclosure of interests.[17]

5.29 SBS also noted that compensation arrangements proposed under the Bill are inconsistent with treatment of the media under the Trades Practices Act. Under that Act, an exemption ensures that media reporting is not unreasonably limited by the consumer protection provisions.[18] SBS Head of Policy, Ms Julie Eisenberg, suggested that, under the new regime, when 'the media was being the media', ie reporting information, it should be allowed equivalent protection.[19] News Limited, FACTS and ASTRA saw that if exemptions are not provided, then market transparency will be reduced with organisations adopting a conservative line to avoid any possible prosecution.[20]

5.30 Given these factors, Fairfax and others asked why the current law and regulations, which can be applied 'clearly and unambiguously' in production of news and financial service publications, should be superseded by arrangements so cumbersome and uncertain.[21] Fairfax asked that the presumption established by the exemption should be reinstated in statute, and not dealt with through regulation, to take the media out of the ambit of the Bill.[22] FACTS and ASTRA saw that ASIC's Policy Proposal should make clear that its policy stance under PS 118 will still apply under the regime.[23] SBS considered that the current law and regulations should be reinstated under the new regime and requested the opportunity to engage in consultations before the legislation was finalised.[24]

5.31 In recognition of the concerns brought to the inquiry by the media, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, wrote twice

16 Submission no. 71, p. 2, and see also News Limited Submission no. 70, p. 5.

17 See for example, News Limited Submission no. 70, pp. 6–7; Reuters Submission no. 71, p. 1; and Australian Press Council Submission no. 74, pp. 2–3.

18 Submission no. 80, p. 3.

19 Committee Hansard, p. 174.

20 Submission no.70, p. 7, and Submission no. 79, p. 4.

21 For example, see Submission no. 62, p. 5.

22 Committee Hansard, p. 184.

23 Submission no. 79, p. 5, and see Committee Hansard, p. 183.

24 Submission no. 80, pp. 3–4.

to the Committee Chairman addressing issues raised.[25] In an attachment to his first letter, the Minister advised that 'it is not the Government's intention to change the practical effect of licensing requirements for media organisations'.[26] He stated that, in view of the media's concerns, the Government was considering an exemption for the media in the regulations or through the means of ASIC's exemption powers.[27]

5.32 The second letter announced the Government's intention to draft a regulation which would preserve the presumption that general advice provided through the media will not require a license, subject to certain disclosure requirements.[28] At hearings on 27 June 2001, the Department of the Treasury confirmed that the regulation was being drafted. Ms Vroombout stated that it is intended that the regulation will exempt the media under the definition of general advice, as do current arrangements.[29]

Telephone tape recording proposal

Introduction

5.33 The Bill contains a general requirement for a bidder or target to record all telephone calls made during a takeover bid period to holders of securities in the bid class. The stated objective of the proposal is to provide a greater level of protection to small shareholders from breaches of the Corporations Law, especially in regard to misleading or deceptive conduct. The proposal would require shareholder canvassers to keep a taped record of every outbound conversation with shareholders for a period of twelve months.

5.34 Industry participants submitted that the proposal was unnecessary and unjustified, having been formulated without any consultation with affected businesses. They noted that there is no international precedent for the proposal and that it could severely inhibit takeover activity in this country. They also protested that the Bill was not targeted strategically to realise its objective of protecting small shareholders. Under the present drafting, all communications with sophisticated (or wholesale) investors would have to be recorded. Submissions argued that this would compromise confidentiality essential to business, and would establish precedents for intrusion in an already tightly regulated industry. It would also impose unmanageable operational requirements such as the archiving of vast quantities of recorded material.

5.35 The Committee also heard that the industry is well established in Australia and operates under strict self-regulation, designed to ensure customer confidence and to prevent any incidence of misleading advice for which the operators would be liable.

---

25 Received and tabled on 13 and 25 June 2001, respectively.

26 Attachment to letter to Senator Grant Chapman, Chairman, Parliamentary Joint Committee on Corporations and Securities, dated 13 June 2001.

27 Letter to Senator Grant Chapman, Chairman, dated 13 June 2001, p. 2.

28 Letter to Senator Grant Chapman, Chairman, Parliamentary Joint Committee on Corporations and Securities, dated 25 June 2001, pp. 2–3.

29 Committee Hansard, p. 270.

Evidence was received from established operators which conduct shareholder canvassing campaigns; CDM Telemarketing, which runs a call centre specialising in communications during bidder/target situations, and Georgeson Shareholder Communications, the world's largest global proxy solicitation company.[30] Their views were endorsed by the Law Council of Australia, International Banks and Securities Association of Australia, the Securities Institute of Australia, and the Chartered Secretaries Australia.[31]

A 'self regulating' industry

5.36 At hearings on the 14 June, Managing Director of Georgeson Shareholder Communications, Mrs Maria Leftakis, told the Committee that shareholder telephone canvassing, which has been used in Australia since 1983, has developed quite different characteristics and conventions from other types of shareholder or investor telephone canvassing, such as for financial product marketing or sales calls. Mrs Leftakis explained that shareholder telephone canvassing—where people are being asked to accept an offer or to vote their shares during takeovers, mergers and transactions—is a low profile process in which confidentiality is a priority. During the takeover process, the shareholder discusses private investment business and the information gathered is never made public.[32]

5.37 To safeguard the position of both the caller and the client, Georgeson Shareholder and CDM Telemarketing submitted that they have adopted a well developed self-regulation framework. This includes giving the shareholder the opportunity to opt out at the start of the call, and provision of standard scripts and Frequently Asked Questions (FAQ) lists, which are vetted by internal and, sometimes, external experts before delivery to every shareholder contacted. The calls are then closely monitored by supervisors and the callers subject to strict operational rules that prohibit them from varying the script, including to offer comment, opinion or casual observation.[33]

5.38 Given this, Georgeson Shareholder and other submitters took the view that the legislation seems to have been drafted with little knowledge of the actual operations or profile of the industry it proposes to regulate. All confirmed, for example, that there is no record of complaint in the industry—with no cases being bought before ASIC, the Trade Practices Commission or reported by the media.[34]

5.39 In its submission Georgeson Shareholder further noted that the only recorded incidences of dispute related to shareholders being unhappy about a takeover bid, or

---

30 Submissions nos 1 and 20.

31 Submission nos 21; 24 and 24A; 58 and 65

32 Committee Hansard, pp. 238–39.

33 Committee Hansard, p. 239, and see CDM Telemarketing Submission no. 20, p. 1, and the Securities Institute of Australia, Committee Hansard, pp. 166–67.

34 See for example submission nos 1, p. 3; 20, p. 1; and 21, p. 2.

objecting on grounds of their privacy being transgressed. The submission records that the incidence of such calls is approximately 2 per 100 000 phone calls. The number of such incidents reported by the aggrieved shareholder to the client is about 1 per 500 000 phone calls.[35] CDM Telemaketing agreed that the incidence of these types of complaint is extremely low.[36]

5.40 At hearings, Mrs Leftakis also alerted the Committee to section 995 of the Corporations Law which explicitly prohibits:

> a person from engaging in conduct which is or is likely to be misleading or deceptive in, or in conjunction with among other things, the making of takeover offers or a takeover announcement, or the making of an evaluation of, or of a recommendation in relation to, takeover offers or offers, or offers constituted by a takeover announcement.[37]

She noted that this, in combination with the consistent record of successful self-regulation exhibited by the industry since at least 1995, has ensured that the consumer protection the legislation aims to achieve is already taken seriously by shareholder canvassers.[38]

Operational difficulties

5.41 In addition, submitters stated that if the proposal goes ahead as drafted it will impose possibly insurmountable difficulties on the industry. Primary among these was the scope of the proposal. In its preliminary submission, IBSA remarked on the Bill's failure to limit the requirement to small investors.[39] The Law Council of Australia predicted many unintended consequences in the proposal's failure to differentiate between mass communications with retail shareholders, and more specific communications with strategic or institutional shareholders. The Council also noted that the Bill does not clearly define which telephone calls will be regarded as being made by the bidder or target during a bid period.[40]

5.42 IBSA advised that this last problem will complicate the already great practical difficulties in ensuring that tape recording equipment is available to record conversations of all types, including regular business calls, in all situations and by all methods, such as when using a mobile phone.[41] In this regard, submissions rejected the Government's assertion that the taping of telephone calls will be the most 'straightforward and cost-effective means' of realising consumer protection

---

35 Submission no. 1, p. 4.

36 Submission no. 20, p. 1.

37 Committee Hansard, p. 241.

38 Committee Hansard, p. 241.

39 IBSA Submission no. 24, p. 1.

40 Submission no. 21, p. 4.

41 See IBSA supplementary Submission no. 24A, p. 3.

objectives. Witnesses reported significant costs will be involved, with Georgeson Shareholders estimating an outlay of at least $200 000 if a company has digital telephony, or $600 000 if it does not, with little benefit to the consumer.[42]

5.43 The proposal was also thought to impose other hurdles for the future of the industry. As noted, privacy is regarded as a priority in the takeover process. Georgeson Shareholders asserted that requirements to advise clients that their discussions were being recorded would be a strong disincentive to many to continue the call, with inevitable effects on the takeover process and shareholder canvassing industry.[43] The Securities Institute of Australia was also concerned that telephone monitoring would inhibit takeover activity and set a precedent for undue regulation.[44]

5.44 Finally, IBSA noted that some banks have a policy of not recording calls, even in dealing rooms, and that the significant costs involved in setting up and continuing to comply with the requirements will undermine Australia's potential to compete as a global finance centre.[45] In this regard, the Law Council of Australia advised that the proposal was inconsistent with global practice and that, in an era of globalised markets, Australia should be cautious about adopting it, given it has not been considered in any other comparable jurisdiction.[46]

5.45 Given these factors, IBSA asserted that to introduce the proposal would be counter to the interests of the industry, introducing unnecessary costs and inconvenience for market participants without affording advantage to small shareholders. Its preferred solution was to refer the proposal to the Companies Securities and Advisory Committee for proper analysis and advice.[47] Georgeson Shareholder stood on the 'unambiguously clean' record of the industry in rejecting the need for regulation over and above that provided by self-regulation and the Corporations law. [48] However, given the Government's concerns, these firms, among other submitters, suggested some possible alternatives to the proposal.

Possible alternatives

5.46 Georgeson Shareholder, along with CDM Telemarketing, recommended that the sales scripts could be lodged with ASIC prior to the commencement of any campaign.[49] However, Georgeson cautioned that this was intended only as 'a measure of good faith'. It did not consider that ASIC should be involved in actual assessment

---

42 Committee Hansard, p. 242, and see IBSA Submission no. 24A, p. 3.

43 Committee Hansard, p. 240.

44 Submission no. 58.

45 Supplementary Submission no. 24B, pp. 1–2.

46 Submission no. 21, p. 3.

47 Submission no. 24A, p. 4.

48 See Committee Hansard, p. 242.

49 Submission no. 20, p. 2, and Committee Hansard, p. 242.

of the scripts, as the time needed for such an appraisal would not be feasible given that some campaigns are run at very short notice.[50]

5.47 The Securities Institute of Australia and IBSA also saw that ASIC might play a role in adopting a self-regulatory set of guidelines developed by industry.[51] In this regard, Georgeson Shareholder saw room to require that telephone shareholder scripts should include an opt-out question, and should continue to be approved by legal advisers and companies.[52] CDM Telemarketing suggested that the thrust of any proposed legislation should be aimed at telemarketers who are not supervised and do not use legally approved scripts.[53]

5.48 The Minister for Financial Services and Regulation responded to these concerns in his letter to the Chairman of the Committee, received and tabled at public hearings on 25 June 2001. In the letter he announced his intention to move an amendment which would narrow the ambit of telephone monitoring during takeovers to calls to retail shareholders. At hearings on 27 June, the Department of the Treasury confirmed the Minister's intentions.[54] However, the amendments introduced with the Bill, and passed by the House of Representatives on 28 June, did not address the tape recording issue.

Issues relating to Australia as an international financial centre

5.49 The stated aims of the Bill include enhancing Australia's international competitive position and its role as a global financial centre. In this context the Bill implements a major recommendation of the Committee's report on the draft Bill that the shareholder limitation on the Australian Stock Exchange Limited be increased from 5 per cent to 15 per cent. In relation to the present Bill, however, the Committee received evidence that some of its provisions may tend to hinder these aims.

5.50 Morgan Stanley Dean Witter Australia Limited submitted that there were a number of aspects of the Bill which had the potential to impede significantly the ability of substantial foreign groups to continue to provide financial services to Australians. These concerns arose from the broad ambit of the licensing regime and the absence from the Bill of the existing provision under which unlicensed overseas entities may operate through Australian licensees. Morgan Stanley submitted that a provision in the Bill for a licensing exemption for certain services provided only to wholesale clients was important and welcome, but was still defective.[55]

---

50 Committee Hansard pp. 242–43.

51 Committee Hansard, p. 168, and supplementary Submission no. 24B, p. 2.

52 Committee Hansard, p. 243.

53 Submission no. 20, p. 2.

54 Committee Hansard, p. 271.

55 Submission no. 12, pp. 1–2.

5.51 Morgan Stanley advised that the existing structure was vital for overseas financial service providers accessing the Australian market. The present structure allows the use of the full resources of substantial foreign entities, while also complying with investor protection and market integrity provisions through an Australian licensed dealer. Under the Bill, however, Australian licensed subsidiaries would have to operate on their own account, with extra costs in IT, booking, risk management and other infrastructure. Morgan Stanley put to the Committee that this may not be cost effective, given the size of the Australian market.[56]

5.52 Goldman Sachs Australia Pty Ltd expressed similar concerns about what it sees as the wide scope of the Bill, which it advised, appears to extend to activities which have little connection with Australia. Goldman Sachs accepted that while it may be appropriate, particularly in relation to the Internet, to regulate financial products from overseas which are sold to Australian retail customers, the same considerations may not be present in the wholesale market. Australian wholesale consumers should have access to foreign financial products which can provide wider choice and reduced cost. In a reflection of the Morgan Stanley submission, Goldman Sachs argued that the exemption from the Bill of certain overseas providers of wholesale financial services is insufficient for the practicalities of the market.[57]

5.53 Goldman Sachs advised that omissions in the Bill, together with its broad scope, could result in overseas providers of financial services to Australian customers through Australian licensed service providers coming within the ambit of the Bill. This would require those overseas providers to become licensed, which is not the case under the present law. Consequently, overseas financial markets and products may be less available to Australian wholesale customers. The Bill even appears to require overseas custodial services performed for Australian clients to be licensed, whether or not the assets in question are Australian. The result may be to deter overseas organisations from providing a full range of services to their Australian corporate clients, due to the required restructuring of their business.[58]

5.54 Goldman Sachs concluded that some participants in large international financial centres may cease servicing Australian wholesale investors, because of the additional burden of Australian registration and the related capital and compliance costs associated with what would likely be only a small part of their total business. Goldman Sachs suggested that this would be the opposite effect to one of the expressed purposes of the Bill, which was to increase competition in the supply of financial services.[59]

---

56 Submission no. 12, p. 2.

57 Submission no. 33, pp. 1–2.

58 Submission no. 33, p. 2.

59 Submission no. 33, p. 2.

5.55 The concerns of these foreign financial services participants were paralleled by a major domestic participant, the Australian Stock Exchange Limited (ASX). ASX officials told the Committee that difficulties remain in relation to the Bill and Australia's international competitiveness in a technologically innovative, integrated globalised market. The stated aims of the Bill are to provide a flexible and competitive supervisory framework, but the ASX advised that the Bill will not assist its efforts to achieve international linkages which fall short of merger. In particular, the Bill does not easily facilitate links between two exchanges by recognising the validity of foreign regulation and thus obviating the need to simultaneously meet Australian and international regulation. The ASX and other Australian operators will therefore remain subject to barriers to entry in foreign jurisdictions; even if these barriers are overcome the Australian operators will have to comply with both the overseas legislative requirements and the provisions of the Bill. The ASX advised that the result would not be a level playing field.[60]

5.56 In response to questions from Committee members, the ASX officials provided written details of a proposed linkage with its Singapore counterparts, to illustrate deficiencies in both the present legislation and in the Bill. The ASX advised that the duplication of the dealer and market licensing requirements across and within the two jurisdictions would not be resolved by the Bill.[61] The ASX advised that the Bill should instead provide a framework for mutual recognition, to be effected by exemption and modification powers. The ASX told the Committee that the Bill or the Explanatory Memorandum should send a clear policy message about the need to facilitate cross-border linkages.[62]

5.57 The ASX further advised that, under the Bill, clearing houses will have two masters; ASIC, which will address fairness and effectiveness, and the Reserve Bank, which will be concerned with financial stability and systemic risk. The ASX submitted that it is unlikely that these two roles will be neatly compartmentalised, which may impede regulatory processes.[63]

5.58 The Institute of Chartered Accountants of New Zealand (ICANZ) raised similar concerns about their members resident in Australia and about their many members resident in New Zealand who have clients in Australia. The ICANZ questioned whether the Bill paid sufficient attention to individuals who may offer financial advice to Australian residents from outside Australia. The ICANZ suggested that it was unclear whether licensing provisions which were intended to operate beyond national borders were workable or enforceable. The ICANZ submitted that an important priority of the Bill should be to facilitate the international trade in services,

60 Committee Hansard, pp. 230–31.

61 Submission no. 93, pp. 1–6.

62 Submission no. 93, p. 7.

63 Committee Hansard, pp. 233–34.

by providing for portable cross-national arrangements that minimise compliance costs for those providing the advice and for regulators.[64]

Issues raised by authorised deposit taking institutions (ADI)

5.59 As noted earlier in this report, the final Bill took into account issues raised by the Committee in its report on the draft Bill, especially in relation to the provision of basic deposit products through agencies in rural and regional areas. The Committee, however, received evidence that these changes may not have gone far enough. For instance, the Australian Finance Conference (AFC), whose submission was supported by the Queensland Association of Permanent Building Societies, advised that the Bill still promised costs and problems for ADI in relation to basic deposit products, even though such products are well understood by consumers and there has been no market failure.[65] The AFC accepted that the concessions are a step in the right direction, but advised that there are still fundamental difficulties with the operation of the exemption.[66]

5.60 The AFC advised that one problem area was unnecessary disclosure statements and competency prescriptions for even simple basic deposit products. The result is more paperwork and administrative costs, which are naturally passed on to customers. Additional costs will result from formalised competency standards for staff training, changes in product development and marketing, delays in the introduction of products, changes to existing products and restrictions on product availability.[67]

5.61 The AFC told the Committee that another problem area was the illogical limit of two years for basic deposit products. This concession will cover most deposits at the present time when interest rates are low. The arbitrary and unnecessary nature of the limit will, however, discourage ADI from offering term deposits beyond two years. This will distort the market when in the future interest rates are higher and there will be greater demand for longer term fixed deposits.[68]

5.62 The AFC asserted that the disincentive to offer such products will be greater for agencies, which in remote areas are more usual than branches. The Bill will discourage financial institutions from using agencies, which will reduce deposit choices available to customers in remote areas.[69]

5.63 In summary, the AFC opposed the application of the Bill to what it advised were simple, well known deposits and non-cash payment facilities. The AFC advised that in relation to **all** deposit products:

---

64 Submission no. 38.

65 Submission nos 11, 11A and see Submission no. 32.

66 Supplementary Submission no. 11A, pp. 1–4.

67 Supplementary Submission no. 11A, p. 2.

68 Supplementary Submission no. 11A, p. 2.

69 Supplementary Submission no. 11A, p. 3.

i. There is no market failure

ii. There is no shortage of consumer information

iii. The products and services are neither new nor complex

iv. The products are low risk and are not subject to market fluctuations

v. Customers clearly understand the products and services

vi. There is an efficient, competitive informed market for the products

vii. The products are subject to strong prudential supervision through the Australian Prudential Regulatory Authority (APRA)

viii. There is no evidence that the benefits to the public from the proposed changes outweigh the costs to government, business and the consumer.

5.64 The AFC therefore recommended that all simple deposit products and related non-cash payment systems be excluded from the ambit of the Bill.[70]

5.65 Most other submissions from ADI approved exemption of the basic deposit products, but advised that they had reservations about whether the provisions would operate in the manner intended. For instance, the Credit Union Services Corporation (Australia) Limited (CUSCAL) questioned the clarity of the provisions. CUSCAL pointed out that many deposit products offered by credit unions include terms and conditions which require notice before withdrawal of money, or terms which impose conditions upon early withdrawal. Other deposit products such as Christmas club accounts impose time restrictions on withdrawal. Credit unions also offer fixed term deposits which include restrictions on withdrawals. CUSCAL advised that in practice there are no penalties on early withdrawals, because the nominal restrictions are merely an aid to prudent risk management. CUSCAL further advised, however, that it was unclear whether these products came within the relevant provision in the Bill as drafted. CUSCAL suggested a minor drafting amendment which would put the matter beyond doubt.[71]

5.66 The Australian Association of Permanent Building Societies (AAPBS), on the other hand, advised that it was generally satisfied with the provisions relating to basic deposit products and related non-cash payment facilities. The AAPBS told the Committee that the changes will go a long way towards enabling ADI to continue to provide basic deposit products. The AAPBS did not expect a decline in the level of service through agents to rural and regional communities in relation to these products,

70 Supplementary Submission no. 11A, pp. 3–4.

71 Submission no. 18, pp. 1–3.

but submitted that obviously the same could not be said for agents who supplied other services, who will be subject to the full rigour of the disclosure regime.[72]

Issues which affect small business

Introduction

5.67 In its earlier report on the draft Bill the Committee identified the impact upon small business as a key issue. In particular, the Committee concluded that the disclosure of the quantum of commission on risk insurance products could unfairly affect small business and recommended that this requirement should be deleted from the Bill. As noted earlier, the Government rejected this recommendation. During its inquiry into the present Bill, however, the Committee received evidence from small business representatives that risk commission disclosure was still a major concern.

5.68 The Committee also received evidence of other small business concerns about the effect of the Bill. The Committee expressly records its appreciation for the small business proprietors and organisations which made submissions to the inquiry and who appeared as witnesses. The Committee is grateful for the direct and emphatic nature of the evidence they presented.

Disclosure of quantum of commission on risk products

5.69 The Life Advisers Action Group submitted that provision in the Bill for commission disclosure on risk business in dollar amounts was the worst possible scenario, reflecting insensitive intolerance towards a legitimate grievance. There is no lack of confidence, at point of sale or otherwise, between life adviser and customer. In fact the major concern of customers is the lack of service and inefficiencies of the life offices. The provision in the Bill serves no useful purpose and could be a serious impediment to a legitimate small business marketing process. There are significant differences between investment products and risk insurance products which justify different approaches to commission disclosure. Agents are influenced not by commissions paid, but by business considerations such as good claims departments and competitive premiums. The main customer issue was that commission is payable, rather than the amount of the commission, which is available on request. There are also practical difficulties in relation to quantum commission disclosure. For instance, commission payable varies according to the services performed by the provider, even though the premium is the same. In addition, it may not be possible to quantify the commission at the point of sale.[73]

5.70 The Association of Financial Advisers (AFA) similarly draws a distinction between investment products and risk products, with full commission disclosure appropriate only for investment products. The AFA advised that the customer makes a decision in relation to risk products based on price, not commission. The major

72 Submission no. 8, pp. 1–2.

73 See Submission no. 4, and Committee Hansard, pp. 78–92.

complaint from consumers is not commission, but lack of quick access to information from life companies about products for which the consumer has already paid.[74]

5.71 Mr Max Harris of Max Harris and Associates Pty Ltd, a firm of financial service consultants, submitted that the provision was unworkable, with no tangible benefit for clients. It would also threaten the viability of small business in this area.[75] The Insurance Advisers Association of Australia advised that disclosure of risk commission does not benefit the consumer, who in any event is able to request information about the commission.[76] The National Insurance Brokers Association submitted that there was no necessity to disclose commission details for risk insurance products.[77]

5.72 On the other hand, the Australian Associated Motor Insurers Limited (AAMI) submitted that it supported the commission disclosure provisions in the Bill as drafted.[78] The Financial Planning Association (FPA) advised that it supported universal disclosure and was concerned that disclosure was required only where commission affects the return from a product. The FPA believed that this would compromise the level playing field for all participants.[79] The Insurance Council of Australia advised that, in the spirit of the Bill, commission disclosure was appropriate.[80]

Other issues affecting small business

5.73 The other main issue raised by small business representatives was the possible adverse effect of the Bill on the financial viability and value of their businesses. Mr Michael F. Murphy of Murphy Financial Services (SA) Pty Ltd, who has had wide experience in the area, submitted that the Bill was against the interests of small business. Mr Murphy told the Committee that the Bill was biased in a number of ways in favour of the product manufacturers or their representatives, who represented the big end of town. Mr Murphy advised that this did not help consumers, who could be best assisted by the advocacy of advisers who were in direct contact with them. Mr Murphy submitted that under the Bill compliance costs were so excessive that those consumers who most needed advice would be unable to obtain it, because they would lack the means to pay. Costs were such that Mr Murphy could now generally open files only for clients with substantial assets.[81]

---

74 Submission no. 6, pp. 1; 4.

75 Submission no. 23.

76 Submission no. 27, p. 1.

77 Supplementary Submission no. 63A, p. 4.

78 Submission no. 56, p. 1.

79 Submission no. 17, p. 2.

80 Supplementary Submission no. 42A.

81 Submission no. 50, pp.1–5.

5.74 Mr Murphy advised that two areas of particular concern were commission disclosure on risk insurance (which is dealt with elsewhere in this chapter) and changes in the principal and agent relationship affecting the agent's right to work. Mr Murphy suggested that if a licensee failed and an administrator or trustee was appointed, the clients would still be funding accumulation plans and generating commission from that income stream, but that neither of these sources of income would be paid to the adviser. The adviser would have no remuneration until the administration was completed, because the clients remain tied to the licensee. The adviser would therefore be obliged to establish a new client base and build up a new portfolio before receiving worthwhile remuneration from the new business.[82]

5.75 Mr Murphy also advised that there would be problems if a licensee suspended or cancelled the proper authority of an adviser for reasons other than fraud or criminal behaviour. Mr Murphy told the Committee that the adviser would be unable to give advice to clients, who may be unaware of the new legal position. Mr Murphy advised that the Bill should provide that in such cases the adviser may transfer the clients, together with their business and income stream, to another licensee without prejudice.[83]

5.76 The Life Advisers Action Group advised that it had reservations about aspects of the Bill affecting small business. The Bill does not appreciate that most financial advisers are small businesses, which employ staff, not sole proprietors.[84] The Association of Financial Advisers (AFA) noted in particular that the Bill changed the present relationship between agents and principals, which affected the financial adviser's right to work.[85]

5.77 The AFA had other concerns similar to those of Mr Murphy. In particular, that the Bill should be amended to provide that, if a licensee is suspended or banned, the individual proper authority will continue to be valid, thus enabling the financial adviser to continue to operate the business as usual. The Bill should also provide for all money owing to the financial adviser from continuing business activity, including continuing commissions, to be paid as in the normal course of business.[86]

5.78 The AFA, again like Mr Murphy, was also concerned that under the Bill a licensee may revoke a proper authority without good reason and without compensation, which is a change from the present position. The Bill makes no provision for compensation for such revocation or for payment of continuing commissions from the adviser's clients. The AFA submitted that this would reduce the market value of agency businesses. The AFA advised that the Bill should provide that

82 Submission no. 50, pp. 6–7.

83 Submission no. 50, pp. 6–7.

84 Committee Hansard, p. 90.

85 Submission no. 6, pp. 2–3.

86 Submission no. 6, p. 3.

an authority may be revoked only for fraud or criminal conduct, pending negotiated resolution of difficulties with natural justice for the financial adviser.[87]

5.79 Mr Lee Carter of Arlington House Pty Ltd submitted that the educational requirements which the Bill provides for licensees may operate harshly in their effect on small business. Mr Carter advised that substantial qualifications at university level and in some cases decades of experience, are disregarded unless the qualifications were obtained comparatively recently. This was the case even if the person in question had maintained membership of professional associations and regularly attended training sessions. Small business proprietors are busy all the time and the changes made by the Bill will increase the workload of financial advisers. The additional educational qualifications could drive small employers out of business, especially given the short deadline for training.[88] Mr Joseph Nowak of the AFA expressed similar concerns.[89]

5.80 Mr John Campbell of One Stop Financial Services advised the Committee that he had concerns about the effect of the Bill on small business. Mr Campbell stated that as a small business operator he was working to build an asset which had a saleable value. The Bill, however, appears to reduce small business proprietors to the status of employees, but to leave the proprietor with all of the costs and liabilities associated with small business. Mr Campbell submitted that these adverse changes made by the Bill will reduce the market value of small businesses.[90]

5.81 Mr Brett Walker of FSI Consulting Pty Ltd submitted that the prohibition in the Bill on the use of terms such as ‘independent’ and ‘unbiased’ to describe a business which received commission would have an adverse effect on small financial advisers. Mr Walker advised that the realities of small business were that the mere receipt of a commission has never been the measure of independence. The real independence of small business is its ability to operate separately from the influence of large institutional players such as banks and insurance companies. Mr Walker submitted that the Bill should be amended to enable small players to retain such expressions, which are one of their major defences against institutional competitors. The various small business representatives also submitted that disclosure of the quantum of commission on risk products would drive down commissions, to the benefit of the large product providers and to the detriment of the smaller operators. This would affect adversely the viability and value of this business.[91]

87 Submission no. 6, pp. 3–4.

88 Submission no. 57.

89 Committee Hansard, p. 111.

90 Submission no. 55.

91 Submission no. 13, pp. 1–2.

Issues relating to the insurance industry

Introduction

5.82 The submissions identified a number of issues of concern to insurance providers, the most important of which are set out below.

Cooling off period

5.83 The Bill provides for a general cooling off period of 14 days within which a financial product may be returned. However, a number of submissions from insurance companies and others, advised of problems in relation to the provision. The Insurance Council of Australia (ICA) noted that renewal invitations are sent to retail clients some weeks before the actual anniversary date, usually much earlier than 14 days. The effect of the Bill, however, is that the cooling off period will start from the date of renewal or the anniversary, which the ICA advised was an unnecessary and impractical level of consumer protection. The ICA therefore recommended that the cooling off period should not apply to renewals.[92] The Australian Associated Motor Insurers Limited (AAMI) advised that a cooling off period was appropriate for new insurance business but was excessive for renewals for which notice is given at least 14 days before the due date.[93] The BT Financial Group similarly advised that the cooling off period should apply only to the initial issue of a product, not to top-up an existing holding.[94] The International Banks and Securities Association of Australia advised that in relation to the cooling off period for managed funds it was important that the foreshadowed regulations in the Bill should provide for adjustments to amounts repaid for market linked products.[95]

Compulsory third party (CTP) and workers' compensation insurance

5.84 A number of submissions advised that these classes of statutory insurance were provided in some States and Territories by private companies and in others by government entities, with undesirable consequences for the operation of the Bill.

5.85 The NRMA Insurance Group recommended that statutory workers' compensation and CTP insurance be excluded from the definition of financial product in the Bill. The NRMA pointed out that workers' compensation issued in some states will not come within the Bill because it is state underwritten, whereas similar insurance in other jurisdictions which is not underwritten by the state will be caught by the legislation. Furthermore, following review by the National Competition Council the status of these schemes could change on a case by case basis, adding to the complexity of the regime. If the Bill retains these clauses of insurance there will be

---

92 Submission no. 42, pp. 13–14.

93 Submission no. 56, p. 6.

94 Submission no. 45, p. 2.

95 Submission no. 60, p. 2.

a double layer of compliance regulation, which would negate the benefits of a single, uniform regulatory regime.[96]

5.86 The Insurance Council of Australia (ICA) expressed similar views, advising that inclusion of workers' compensation and CTP insurance at this stage would simply add more regulation and potential jurisdictional conflict to the already complex regulation imposed at State and Territory level.[97] The AMP Limited advised that the exclusion from the Bill of some products in these classes of insurance but not others was a fragmented and illogical approach.[98] The Australian Associated Motor Insurer Limited (AAMI) submitted that including CTP insurance in the Bill will make regulation more onerous and increase potential regulatory conflict.[99]

5.87 Organisations which made submissions emphasised generally that including workers' compensation and CTP insurance in the Bill would increase compliance costs. The Chartered Secretaries Australia advised that there was a potential for different cost structures, with States with private insurers having higher costs because of the requirements of the Bill.[100] The AAMI and ICA warned of increased costs, which the NRMA advised would be passed on to the consumer.[101]

5.88 The submissions on this general point recommended that these statutory insurance classes should be brought under the Bill only if they were included in a uniform national scheme. There was broad agreement that regulatory uniformity for these classes was desirable, with statutory insurance expressly excluded from the Bill until this could be achieved. The submissions agreed that the Commonwealth in conjunction with the States should commit resources to achieve a single national regulatory framework for CTP and workers' compensation insurance.

Insurance quotes by telephone

5.89 Some submissions advised that the Bill imposed unreasonable restrictions on the provision by telephone of quotes for insurance cover. The NRMA Insurance Group submitted that the requirement in the Bill to provide an oral Financial Services Guide (FSG) to all telephone callers was a significant problem for insurers such as NRMA with a large telephone contact business. In this context NRMA received 100 000 telephone inquiries each week. All inquirers who eventually become customers receive full disclosure documentation and have the benefit of the cooling off period, so the prior oral FSG is unnecessary and costly duplication. Also the requirement did not comply with the competitively neutral intention of the Bill, because financial service providers not significantly dependent upon telephone sales

---

96 Submission no. 25, p. 3.

97 Submission no. 42, pp. 5–6.

98 Submission no. 49, p. 5.

99 Submission no. 56, p. 4.

100 Submission no. 65, p. 5.

101 Submission nos 56, p. 4; 42, p. 5; 25, p. 3.

would have an advantage over others for which this is a major distribution channel. The NRMA therefore recommended that the requirement be removed.[102]

5.90 The Insurance Council of Australia (ICA) also warned that the requirement to provide extensive disclosure information by telephone would increase costs and call times for consumers. The ICA submitted that this would far outweigh any intended consumer benefit, given that the major insurers collectively handle more than 200 000 calls each week. The requirement could overwhelm call centres and put pressure on rural branches and branch agencies. The ICA recommended that extensive oral disclosure should not be required for general insurance transactions by telephone. The AMP Limited endorsed the ICA submission, advising that the requirement would increase costs by 5–8 per cent for each individual policy.[103] The National Insurance Brokers Association also submitted that the provision of a quotation alone for a general insurance product should not be regarded as a financial service. However, if the consumer accepts the quote then the general provisions of the Bill should apply.[104]

Travel insurance

5.91 The Committee received a number of submissions which advised that the Bill would have adverse consequences in relation to the provision of travel insurance. QBE Insurance (Australia) Limited, American Home Assurance Company and Transport Industries Insurance (QBE) submitted that the Bill would have adverse effects on consumers, travel agents and the relevant insurers. QBE advised that aspects of the regime were not appropriate for the sale of simple general insurance risk products such as travel insurance, which are inherently different from investment type products. Unfortunately, however, much of the Bill is based on existing regimes for these investment products. In the absence of suitable recognition of simple risk products the Bill will result in a breakdown of the present distribution structure for those products, with more consumers travelling uninsured or underinsured. In some instances, consumers may look overseas for their travel insurance.[105]

5.92 QBE submitted that to avoid these consequences the Bill should be amended and administrative action taken. For instance, there should be some exemption from the training requirements for representatives in relation to a single retail product class such as travel insurance. Also sub-authorisations should be permitted by all authorised representatives, to enable small businesses and partnerships to sub-authorise their employees and agents. In addition, there should be changes to the requirement for a licensee to notify ASIC within 10 working days of all authorised representatives, which provides no protection for consumers of simple retail products. There should also be appropriate exemptions for products sold over the telephone and for disclosure in relation to the sale of travel insurance by travel agents or airline booking staff.

102 Submission no. 25, p. 2.

103 Submission no. 42, pp. 14–15.

104 Supplementary Submission no. 63A, p. 3.

105 Submission no. 52, pp. 1–2.

Finally, the 14 day cooling off period should be modified to avoid the situation where an insured returns from a holiday within the 14 day period and seeks to exercise the right to return the product.[106] In this context, the Insurance Council of Australia recommended that the cooling off period for short-term contracts should end on the day before the contract begins.[107]

5.93 The Australian Federation of Travel Agents (AFTA) advised that it had worked closely with the companies which had made the QBE submission. AFTA was deeply concerned with impositions which the Bill makes on travel agents, which will inevitably be passed on to the consumer.[108] Thomas Cook Travel (Australia) Pty Ltd submitted that travel insurance sales represent a significant proportion of travel agents' revenue and any reduction of that revenue could adversely affect employment.[109]

5.94 The Australian Travel Agents Cooperative (ATAC) advised that the Bill in its present form makes unacceptable demands on travel agents. The ATAC expressed total support for the QBE submission.[110]

Prohibition on hawking

5.95 The Australian Associated Motor Insurers Ltd (AAMI) and the Combined Insurance Company (CIC) separately raised concerns about the provision in the Bill which prohibits the hawking of financial products. The AAMI advised that it is usual general insurance industry practice to telephone insureds to advise them of other products and to ensure that they are fully covered in the case of loss.[111] The CIC stated that the terms of the prohibition would result in uncertainty and effectively deny access to financial products by substantial categories of consumers. In particular, it would continue the trend for financial service providers to lessen personal contact with consumers in rural areas. The CIC advised that it was appropriate to prohibit the hawking of securities, but not general insurance products. The CIC noted that the general insurance industry was already heavily regulated by Federal and State consumer protection laws, which addressed adequately the type of practice at which the provision in the Bill was apparently directed.[112] Both AAMI and CIC recommended that the prohibition effectively not apply to the general insurance industry.[113] The Insurance Council of Australia endorsed the CIC submission.[114]

---

106 Submission no. 52, pp. 4–5.

107 Supplementary Submission no. 42A.

108 Submission no. 66.

109 Submission no. 88.

110 Submission no. 64.

111 Submission no. 56, p. 4.

112 Submission no. 94, pp. 3–5.

113 Submission nos 56, p. 4; 94, p. 11.

Issues relating to declared professional bodies

Introduction

5.96 In its report on the draft Bill the Committee concluded that concerns expressed in relation to the declared professional bodies provisions were valid. The Government response to the report did not accept this position, although the final Bill includes some amendment of relevant definitions. However, during the present inquiry the Committee received evidence that concerns remain in this area, in regard to both the operation of the provisions and their conceptual framework.

Operation of the declared professional body provisions

5.97 Submissions from professional bodies advised that there would be problems with the operation of the provisions. The Law Institute of Victoria noted that a solicitor acting in a professional capacity has certain well recognised obligations towards clients. The primary obligation is to advise clients on matters of law, but obligations extend beyond legal matters to include all matters which are within the terms of the retainer as well as all incidental or related matters. These obligations may be quite different. It is not open to a solicitor engaged to advise on all aspects of a matter in a professional capacity, to limit advice to matters of a legal nature. Indeed, a professional adviser may be liable for failing to give financial advice outside the terms of the retainer. There is, however, a well known line between a solicitor's professional advice and activities which are entrepreneurial with the two being mutually exclusive.[115]

5.98 The Law Institute of Victoria concluded that there was a clear dividing line between advice provided incidentally as part of a solicitor's professional practice and advice offered in the course of a solicitor's non-legal business activities. The exemption provided in the Bill for incidental advice was, however, too narrow. As presently drafted the Bill will require solicitors to be licensed to provide advice in the normal course of their practice.[116]

5.99 The Law Council of Australia expressly endorsed the submission from the Law Institute of Victoria.[117] In addition, the Law Council of Australia advised that the basic principle for consideration of the Bill should be that it is intended to regulate participants who are centrally involved in the financial services industry. The Bill should not regulate those on the periphery of that industry who may have some influence over another person's dealings with the issuer of a financial product. The Bill, therefore, should not regulate lawyers who provide traditional legal services, but should include within its ambit lawyers who hold themselves out as core players in the

---

114 Supplementary Submission no. 42A.

115 Supplementary Submission no. 7A, pp. 2–4.

116 Supplementary Submission no. 7A, p. 5.

117 Supplementary Submission no. 21A.

financial services industry, such as promoters of mortgage loan schemes.[118] The Law Council of Australia gave instances where, as part of a commercial lawyer's day to day practice, advice is given which is more than legal advice. The Bill in these instances would require the lawyer to be licensed. The Law Council of Australia submitted that public policy did not require further regulation of lawyers, who were already subject to comprehensive supervision. Instead, the Bill should be amended to provide an exemption for all incidental advice provided by lawyers, instead of the narrow and restricted proposed exemption. The existing exemption for lawyers in the Corporations Law/Corporations Act is satisfactory and should be continued.[119]

5.100 A submission from eight of the largest commercial law firms made similar points, advising that they had grave concerns about the application of the Bill to the provision of ordinary commercial legal advice.[120] The submission advised that the Bill should be amended to exempt from its operation advice which is part of ordinary professional practice, including advice which is incidental to this. There is a clear line between such advice and other activities such as, for instance, promoting mortgage or other investment schemes, which should be subject to the Bill. The present exemption for incidental legal advice in the Bill is very restrictive and therefore can be remedied only by amendment and not, for instance, by ASIC interpretation.[121]

5.101 The commercial law firms also submitted that it is impossible for lawyers who are advising clients about commercial transactions to avoid giving commercial advice and that it would be bad public policy if the Bill discouraged lawyers from doing this. The Bill adds another compliance layer for lawyers without measurable benefits. It is plainly false that the claimed regulatory neutrality will be achieved by including incidental advice by lawyers within the scope of the Bill. Any benefits of the Bill for clients would not equal the detriments of increased compliance costs and intrusion into the relationship between lawyer and client.[122]

The conceptual framework of the declared professional body provisions

5.102 The legal professional bodies expressed reservations about not only the operation of the relevant provisions, but also their conceptual framework. The Commercial Law Section of the Financial Services Committee of the Law Institute of Victoria submitted that, despite presumed safeguards for solicitors giving incidental financial advice, the Bill was an unwarranted intrusion into the independence of the legal profession. The requirement that solicitors must limit their advice according to conditions imposed by ASIC would severely restrict the independence of the profession and impede the giving of independent impartial advice to clients.

---

118 Supplementary Submission no. 21B, pp. 1–2.

119 Supplementary Submission no. 21B, pp. 3–4.

120 See Appendix 1, Submission no. 87 for the names of these firms.

121 Submission no. 87, p. 2.

122 Submission no. 87, pp. 2–5.

5.103 The Law Council of Australia advised that it seriously questioned whether ASIC should divert from its core regulatory function to assume additional functions which would essentially amount to the regulation of the legal profession. It is likely that the various law societies may not seek to become declared professional bodies, given the uncertain and potentially onerous obligations which will be imposed upon them. This would effectively result in the legal profession being directly regulated by ASIC.[123]

5.104 The submission from the commercial law firms made the same point, requesting an amendment to the Bill to ensure that neither lawyers nor law societies are subject to ASIC regulatory supervision in relation to ordinary professional practice by solicitors, including advice which is incidental to that practice. There is no assurance that state-based law societies will be willing to become declared professional bodies, with the result that most law firms may need to be licensed. ASIC will therefore be required to oversight lawyers.[124]

5.105 The commercial law firms further submitted that it was not appropriate for ASIC to have regulatory oversight of solicitors in the ordinary practice of their profession, even if that practice includes giving incidental financial advice. ASIC supervision could indirectly compromise fundamental rights such as a client's right to legal professional privilege. Supervision of this nature is an intrusion by government into the relationship between lawyer and client for which there is no justification. Traditionally, communication between lawyers and clients has been protected from discovery by government agencies out of concern that this would deter clients from providing information necessary for them to receive full legal advice. The Bill, however, may overturn this protection by the powers which it gives to ASIC. Under the Bill ASIC may demand information from lawyers even where ASIC has no reason to believe that a law has been breached and where its access is purely random. The commercial law firms submitted that it was bad policy to override such a fundamental right in relation to provisions intended to protect those same consumers.[125]

Professional bodies representing accountants

5.106 Other professional bodies apart from those representing lawyers supported the general position of the legal professional bodies.

5.107 CPA Australia and the Institute of Chartered Accountants in Australia (ICAA) jointly submitted that they were particularly concerned that their members who offer traditional accounting services may inadvertently be caught by the Bill. In this context they advised that the Bill should be specific about who is required to be licensed. CPA Australia and ICAA supported the declared professional bodies provisions, but not as

123 Submission no. 7.

124 Submission no. 87, p. 1.

125 Submission no. 87, pp. 3–4.

a general provision to cover any ambiguity in who should be licensed. Traditional accounting and tax advisory services should be excluded from the Bill.[126]

5.108 The National Institute of Accountants (NIA) advised that the Bill blurred the distinction between the purpose of a professional body and that of a regulator. For instance, it is not the role of a professional body to implement government policies or to be a spokesperson for the government on the regulator. There is also a disparity in that the resources and staff available to professional bodies are not equal to those of regulators. The NIA suggested that there is some consternation over the degree of supervision of members which professional bodies are expected to exercise.[127]

Consumer protection issues

Introduction

5.109 The Government has stated that the changes introduced by the Bill will deliver considerable benefit to consumers.[128] Nevertheless, while a principal object of the single licensing and disclosure regimes has been to simplify and make more transparent the activities of financial service providers, some aspects of the legislation have been criticised as having potentially negative implications for consumers.

5.110 Consumer organisations identified a range of technical or operational difficulties arising from the Bill. Concerns were expressed about the effects of exemptions from disclosure or licensing requirements which may allow training standards or the quality of advice to be reduced under the Bill. In particular, consumer organisations questioned exemptions for bank clerical staff and rejected proposals that risk insurance products should be exempted from commission disclosure requirements. The Committee also heard that controls on pressure selling under the Bill were not wide reaching enough to protect consumers.

5.111 Doubts also arose about the effectiveness of the conceptual framework proposed for professional bodies, in which both exemptions from licensing requirements and obligations as industry regulators would apply. At hearings the operation of dispute mechanisms was a focus of concern with the independence of the external dispute schemes, such as the Financial Industry Complaints Service (FICS), being questioned. Finally, the Committee was advised by representatives of ethical investment groups about growing consumer interest in socially responsible investment (SRI) products.

5.112 Since the submissions were received, some of the consumer issues raised have been addressed or partially addressed by the Financial Services Reform (Consequential Amendments) Bill 2001 or by the Government's amendments to the

---

126 Submission no. 40, p. 1.

127 Submission no. 48, *passim*.

128 'Hockey Introduces Financial Services Reform Bill', Minister for Financial Services and Regulation, *Press Release* no.SR/025, 5 April 2001.

Financial Services Reform Bill 2001, introduced in the House of Representatives on 7 June and 28 June respectively. Two such matters related to the Bill's failure to update mirror provisions under the ASIC Act to reflect those in the Trade Practices Act, and the removal of fairness obligations which stood in the Corporations Law and in the draft exposure Bill.

ASIC Act/Trade Practices Act mirror provisions

5.113 In its submission, the Financial Services Consumer Policy Centre expressed the view that the Bill should include provisions updating the ASIC Act, so to more accurately reflect amendments to the Trade Practices Act. The FSCPC reminded the Committee that mirror provisions in the Trade Practices Act (as amended in 1998 and 2000) and those in section 12 of the ASIC Act had been inserted when financial services were removed from the Australian Competition and Consumer Commission's consumer protection jurisdiction. At that time, the Government had pledged that ASIC's powers would keep pace with those in the Trade Practices Act.[129]

5.114 The FSCPC advised that this has not happened, resulting in the following inconsistencies:

- the TPA now protects small business from unconscionable conduct, while the ASIC Act is limited to personal clients (1998 amendments);
- maximum penalties under the TPA were increased from $44 000 to $220 000 for individuals and from $220 000 to $1.1 million for corporations while the penalties under ASIC Act remain unchanged;
- the ACCC has been empowered to intervene in private litigation while ASIC has not (2000 amendments); and
- the TPA now has a uniform limitation period of six years while the ASIC Act still contains a mixture of two and three year limitation periods.[130]

5.115 The FSCPC concluded that this is unacceptable, and creates a situation where small business is subject to maximum penalties five times greater than those faced by a large corporation, such as a bank.[131]

5.116 At hearings in Sydney on the 13 June, the Director of the FSCPC, Mr Chris Connolly, was pleased to advise that the Centre's concerns had been addressed by the Financial Services Reform (Consequential Provisions) Bill 2001.[132] The Bill ensures

129 Submission no. 37, pp. 2–3.

130 Submission no. 37, p. 2.

131 Submission no. 37, p. 3.

132 Committee Hansard, p. 55.

that ASIC will now have the same powers, penalties and limitations available to it as the ACCC.[133]

Removal of the obligation to act 'fairly'

5.117 Consumer organisations alerted the Committee to a possible weakening of the obligation to act with integrity in the marketplace as a result of the present drafting of the Bill. The Australian Consumer's Association (ACA) and the Consumer Credit Legal Service noted that where the Corporations Law and the draft FSR Bill required providers to act 'efficiently, fairly and honestly', the Bill now asks that providers only act 'competently and honestly' and 'to the extent that it is reasonably practical to do so'.[134]

5.118 At hearings in Sydney on 13 June, the FSCPC's Mr Connolly told the Committee that the removal of the obligation to act fairly, with the qualification to meet the new requirement as far as 'is reasonably practical to do so', will make it difficult for consumers to prove a case of misconduct in court. He noted that the fairness requirement has been used successfully in previous court cases to argue that there is a requirement for advisers to act ethically, and that there seems to be no obvious reason for withdrawing the obligation to fairness. Ms Louise Petschler, Senior Policy Officer of the ACA, also told the Committee that the meaning of 'reasonably practical' was quite unclear and that a number of major law firms were concerned about its potential application.[135]

5.119 In a letter to the Chairman of the Committee on the 25 June 2001, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, announced the reinstatement of the obligation to act fairly into the legislation in amendments to the FSR Bill.[136] At hearings on 27 June in Canberra, Ms Vroombout of the Department of the Treasury reported that the Minister had determined to return to the position in the current Corporations Law, following representations that there was a body of case law relying on the obligation to act fairly.[137]

5.120 The amendments were introduced into the House of Representatives on 18 June 2001, and were passed in the House with the FSR legislation on 28 June 2001. The amendments did not, however, withdraw or clarify what might be considered 'reasonably practical' in meeting the obligation.

5.121 In explanation of the qualification at hearings on 27 June, the Department of the Treasury's Ms Vroombout stated that it may not be possible (or practical) to act

---

133 See Financial Services Reform (Consequential Provisions) Bill 2001, Explanatory Memorandum, House of Representatives, the Parliament of the Commonwealth of Australia.

134 Submission no. 44, p. 4, and Submission no. 41, pp. 1-2.

135 Committee Hansard, p. 63.

136 The letter was tabled at a public hearing in Canberra on the same day.

137 Committee Hansard, p. 270.

'efficiently, honestly and fairly' in equal measure, in that, for example, something that is very efficient might not be very fair. She advised that the legislation therefore required that a 'balance of all three' attributes should be achieved, and not just any one or two. [138] ASIC also confirmed that the requirement for meeting all criteria had a long history in the securities regime but suggested that any qualification of the requirements by notions of what was 'practical' had to be considered a policy interpretation to be explained by Treasury.[139]

Basic deposit products

5.122 The ACA submitted to the Committee that the Bill created a lower standard of disclosure in retail banking, an area where consumers report difficulty in comparing and understanding products. The ACA also advised that this was an area where consumers often find themselves in accounts which are expensive and difficult to understand, against alternatives that might better suit their needs.

5.123 The ACA was also concerned that training and competency requirements for staff providing basic deposit products was unclear, and the extent of consumer redress difficult to ascertain. The ACA recommended to the Committee that the Bill and the regulations clearly establish that training and competency standards to be applied to staff dealing in basic deposit products must be sufficient to ensure consumers are directed to the appropriate accounts, that all conditions and fees are adequately explained and that areas where further advice should be sought from representatives are clearly understood. The ACA also recommended that breaches such as consumers being directed to inappropriate accounts where lower cost alternatives exist, receiving inadequate explanations of conditions and charges, and receiving inappropriate recommendations on rollover, must be subject to compensation for the consumer.

Exemptions for bank 'clerks and cashiers'

5.124 Consumer groups also argue that industry standards will be lowered, rather than improved, if training or advice requirements are made flexible for particular individuals or industry groups, especially given the emphasis in the legislation on self-regulation and sectoral standard setting.

5.125 At hearings in Sydney on 13 June, Ms Petschler of the ACA told the Committee that the standard of training and competency in the financial services industry is 'one of the most contentious issues' in debate about the consequences of the FSR Bill. In particular, concerns have focussed on exemptions for 'clerks and cashiers' providing advice on basic deposit products.[140] These exemptions hinge on the definition of personal advice, with those employees who do not actually offer

138 Committee Hansard, p. 295.

139 Committee Hansard, pp. 354–55.

140 Committee Hansard, p. 58.

advice about financial products being exempt from meeting competency levels required for financial advisers under the Bill.

5.126 In the Committee's report on the draft Financial Services Reform Bill, exemptions for clerks and cashiers in the banking industry were recommended on the basis that counter staff carry out routine tasks such as taking deposits, so should not need to be qualified. The recommendations aimed at relieving concerns that the legislation would put undue pressure on rural and regional financial service providers, given that some operate through such outlets as pharmacies and newsagents.[141] Amendments were included in the present Bill and welcomed by the Australian Association of Permanent Building Societies, for example, which judged that the changes would sustain the present level of services in non-metropolitan areas.[142]

5.127 However, at hearings, the ACA warned the Committee that the exemptions would potentially lower the level of competency that the ASIC Interim Policy Statement 146 (IPS 146) *Training of Authorised Representatives* aims to maintain in the banking industry. Ms Petschler noted that the statement provides for a two-tier level of training; with a lesser training requirement for providers of general advice, as against personal advice, which nevertheless ensures adequate competency for the type of direction being given to consumers. She advised that the ACA wished to send a strong message that, for the FSR Bill to be successful, 'we cannot afford to exempt these large classes of direct sales and face-to-face contact that consumers have in financial services'.[143]

5.128 The ACA therefore opposed the introduction of exemptions for cashiers and clerks as being contrary to the spirit and objectives of the Bill.[144] The Consumer Credit Legal Centre (NSW) Inc. supported this view, noting that there is currently a paucity of information about suitable banking options for consumers. The Service concluded that: 'Any blanket exclusion of work ordinarily done by clerks and cashiers creates a serious inroad into the proposed consumer protection regime'.[145]

5.129 At hearings on 27 June, the Committee sought to establish the Department of the Treasury's intentions in regard to this aspect of the legislation, and also to ascertain ASIC's views on its interpretation of the provisions related to basic banking products. Both organisations emphasised that the exemption was intended only for those conducting clerical activities such as 'taking money and issuing receipts'.[146] ASIC advised that as soon as any degree of judgement was exercised then this had to be considered as giving advice and staff had to be appropriately authorised and

141 Report on the Draft Financial Services Reform Bill, August 2000, pp. 15–17.

142 Submission no. 8.

143 Committee Hansard, p. 58.

144 Committee Hansard, p. 58.

145 Submission no. 72, p. 2.

146 Committee Hansard, p. 307.

trained.[147] Ms Vamos told the Committee that competency at Training Tier 2, the lesser training level under IPS 146, would be required of all tellers having the responsibility for giving advice.[148]

5.130 ASIC also advised that the Bill distinguishes between this situation and one in which the teller acts as a 'mere conduit': where product information is given on the request of a customer and, perhaps, the client is referred on for advice.[149] This would apply in the case of two-year term deposits where disclosure, rather than training and authorisation, requirements would operate.[150]

5.131 The Department of the Treasury only partly concurred with this, noting that in these circumstances, disclosure requirements would operate in addition to those for training, with authorisation requirements being exempt.[151] Treasury's representative also conceded that tellers dealing with bank deposit products may be under pressure to sell other products and so, to that extent, the full picture in relation to banking products may not be revealed to the consumer.[152]

Exemptions for 'acting outside authority'

5.132 At Sydney hearings on 13 June, the Australian Consumer Association and the Financial Services Consumer Policy Centre also identified problems arising for consumers under the provisions of the Bill which would exempt licensees from liability if their representative discloses that they are 'acting outside authority' when advising clients.

5.133 In its submission, the FSCPC reported that it is the experience of the consumer movement that such an exemption will function as a 'loophole' leading to deliberate abuse of the consumer. The submission cited the case of the 'pay day lending' industry which sprung up to exploit a small provision in the Uniform Credit Code which exempts short term lending.[153]

5.134 Representatives of the ACA also expressed concerns that the exemption would allow salespeople to promote products as special opportunities, while exempting themselves from responsibility by announcing they are 'acting outside of authority'. Ms Petschler saw that a consumer, unaware of the function of the exemption, may imagine that the liability for advice would be carried by the licensee—a life office or whomever the agent represents.[154] The Consumer Credit

147 Committee Hansard, p. 346.

148 Committee Hansard, p. 348.

149 Committee Hansard, pp. 351–52.

150 Committee Hansard, p. 346.

151 Committee Hansard, p. 304.

152 Committee Hansard, p. 306.

153 Submission no. 37, p. 5.

154 Committee Hansard, p. 57.

Legal Service, in its submission, also judged that consumers are unlikely to recognise the full implications of the exemption and so advised that it is 'vital for consumer protection that consumers have redress to a licensee for the actions of a representative'.[155]

5.135 Given this, consumer organisations were opposed to the provision. They recommended that either the exemption should be removed or that the legislation should state clearly that it applies only where a financial services product is not being discussed or provided.[156] The ACA's Ms Petschler also advised that, if the exemption is to apply, then ASIC should provide clear direction on disclosure, and that this should require that the parts of a product being offered that are not within the authority of the agent should be clearly identified.[157]

5.136 Asked to explain the rationale of the exemption at hearings in Canberra on 27 June, the Department of the Treasury's Ms Vroombout advised that the current legislation intends to encourage licensees to cross-endorse people, by having the authorised representatives—the multi-agents—rather than the licensees, carry liability for any misconduct. She also informed the Committee that the decision to have the legislation drafted this way, rather than attributing liability to all licensees represented, was ultimately 'a question of policy'.[158]

5.137 Seeking to clarify the implications for consumers, the Committee later asked ASIC what role a licensee might play in monitoring whether a representative was acting within authority. ASIC representatives emphasised that a 'key licensee obligation' under the legislation is to supervise and monitor their representatives, and this would include ensuring that they act within authority.[159] However, ASIC confirmed that, under the exemption, if an authorised representative declares he or she is acting outside authority, then only the representative is liable for any bad advice given, whether or not the representative is acting for one or more licensee. That is, the requirement to prove liability of a particular licensee in this situation is no longer relevant, as all are exempted from responsibility.[160]

Exemptions for 'declared professional bodies'

5.138 Under the new regime, professional bodies may apply for a declaration which will exempt their members from the requirement to obtain a financial services licence, providing they are not actually dealing in a financial product. This means that they will also be exempt from training requirements for licensees as their professional

---

155 Submission no. 41, p. 2.

156 The Consumer Credit Legal Centre Submission no. 41, p. 2 recommended removal, while the FSPC Submission no. 37, p. 5 and ACA Submission no. 44, pp. 10–11 recommended removal or clarification.

157 Committee Hansard, p. 58.

158 Committee Hansard, pp. 296–97.

159 Committee Hansard, pp. 339.

160 Committee Hansard, pp. 339–40.

status deems them equivalently qualified to offer 'traditional' services, such as providing legal advice or accounting services. The qualification of 'incidental advice' will also allow them to give related information, such as commercial judgments, if this is provided in appropriately open ended fashion (ie specific products are not suggested).

5.139 The proposed exemption for declared professional bodies, such as lawyers and accountants, remains contentious for both industry and consumer groups. While many professional bodies strongly supported exemptions for incidental advice and asked for its extension to cover a broader class of financial advice, others saw problems arising from the present drafting of the legislation, with some questioning its workability. Still others were uncomfortable about ASIC's role in interpreting the exemption and asked for certainty about the application of the exemption in the legislation.

5.140 Recognising a potential for confusion and inconsistency, the Association of Superannuation Funds of Australia (ASFA) submitted that exemptions for 'declared professional bodies', runs counter to the objectives of the Bill which require that the same competency standards should be applied for all providers of financial advice.[161] The ACA supported this view, noting that the exemption had the potential to weaken the consumer protection framework intended by the single licensing regime. The ACA also questioned the assumption that professional codes of practice will be adequate to comply with the new regime's licensing requirements.[162]

Obligations of professional bodies

5.141 A related issue raised by the ACA submission was that the exemption for declared professional bodies was at cross-purposes with the expectation that the same professional bodies will be required to oversee the compliance of their members. The ACA saw dangers arising from self-regulation in this instance, citing the example of the solicitors mortgage schemes, where consumers had relied on professional bodies to adequately regulate member activities, with major problems resulting.[163]

5.142 While the Australian Financial Markets Association and the Securities and Derivatives Industry Association, in its joint submission, welcomed the opportunity to self-regulate, and to do so in partnership with ASIC, many in the industry were also uncomfortable about the new requirements. The National Institute of Accountants, for example, wrote that the legislation mistakes the role of professional bodies. The NIA pointed out that professional bodies are ill-fitted to act as regulators, and do not have

161 Submission no. 16, p. 18.

162 Submission no. 44, p. 12.

163 Submission no. 44, p. 12.

access to the information required by ASIC to monitor compliance, nor the resources to set up mechanisms for that purpose.[164]

5.143 In its submission the ACA agreed, noting that the exemption raises concerns about administration and enforcement:

> ACA has little confidence that professional bodies will be able to apply adequate monitoring, compliance and enforcement regimes for members, provide appropriate redress to consumers, or to report systemic or individual breaches of the legislation. While the revised Bill improves on the original exemption in the Exposure Bill (for example, in relation to ASIC monitoring powers, and incidental advice), it does not adequately address these consumer protection concerns.[165]

5.144 The NIA also judged that the role of regulator does not fit comfortably with that of industry representative: where the body looks after the interests of its members and represents their views to government and others.[166] At hearings on 13 June 2001, the ACA also alerted the Committee to this potential conflict of interest, and considered that, from a consumer point of view, it would be preferable to have ASIC as the regulator rather than give professional organisations this responsibility.[167]

5.145 To improve consumer protection under the exemption, the ACA and ASFA recommended that the law should require that the competency levels of any exempted body giving personal advice should be no lower than that demanded by the licensing regime.[168] The ACA also suggested that ASIC's power to approve declarations should be contingent upon a professional body providing evidence that it had the capacity to meet the training and competency standards of the FRS reform in full.[169] ASFA also recommended that, before granting professional body status, ASIC should consult with stakeholders who are likely to be affected by the actions of that professional body.[170]

5.146 The ACA also expressed doubts that the present drafting of the legislation awards ASIC sufficient power to withdraw an exemption from a professional body once it has been given. It therefore recommended boosting ASIC's powers to act against bodies where any breach had occurred. However, the bottom line for the ACA

---

164 Submission no. 48, p. 9.

165 Submission no. 44, p. 12.

166 Submission no. 48, p. 9.

167 Committee Hansard, p. 66.

168 Submission no. 16, p. 18.

169 Submission no. 44, p. 13.

170 Submission no. 16, p. 18.

was that, in the interests of safeguarding the operation of the licensing regime and for sound consumer protection standards, the exemption should be removed.[171]

Dispute resolution mechanisms

5.147 As indicated above, some professional bodies and consumer groups were concerned that the requirement that professional bodies act as regulators of their members would compromise their role as providers of independent advice both to these groups and to Government. A related concern was how effective and independent external dispute complaint boards and panels, of which there are six, will be under the new regime.

5.148 At hearings on the 13 June, the Chairman of the Australian Shareholders Association, Mr Ted Rofe, reported that, in his experience, the Financial Industries Complaints Service (FICS) is not, under the present regime, working well. He stated that there were complaints about delays and a perceived bias because the scheme is financed by industry.[172]

5.149 The issue of the independence of external dispute mechanisms, such as the FICS, emerged as a key issue for consumer representatives at hearings. Mr Connolly of the FSCPC told the Committee that:

> It is no secret that since 1999 the consumer movement…has been involved in a dispute with the schemes, the minister, the regulator, et cetera, about whether or not these schemes are actually independent. Our concerns are that the benchmarks state that consumer representatives should be appointed to the schemes in order to ensure independence. While that happened up until 1999, since that time the appointments to the specific schemes in financial services have been inappropriate, and the people appointed have not been consumer representatives and have not been people who have the confidence of the consumer movement, as required by the benchmarks. Those appointments have in fact undermined confidence in the schemes.[173]

5.150 Mr Connolly cited as examples the recent appointments made by the Minister of Financial Services and Regulation to FICS. He noted that the appointments did not result from a national advertising campaign, something which consumer groups had agreed (under some models) was a prerequisite.[174] Mr Connolly also judged the appointees did not have appropriate experience of consumer advocacy to qualify, given that merit based selection, preferably of individuals with casework or legal experience, is essential.[175]

---

171 Submission no. 44, p. 13.

172 Committee Hansard, p. 139.

173 Committee Hansard, pp. 60–61

174 Committee Hansard, p. 70.

175 Committee Hansard, p. 72.

5.151 However, at hearings in relation to the Committee's oversight of ASIC on the 14 June, Deputy Chairman Ms Jillian Segal told the Committee that ASIC was not formally investigating the appointments as this was not 'appropriate'. Instead, she emphasised that ASIC, the Minister and consumers associations 'all have a common interest in ensuring that the schemes operate properly to provide consumers with the appropriate venue for alternative dispute resolution'.[176] In this regard, Mr Peter Kell, Executive Director, Consumer Protection, reported that ASIC is 'confident that the schemes can work well'.[177]

Commission disclosure on risk-based and insurance products

5.152 In contrast to submissions from life agents, reported elsewhere in this chapter, consumer and some other industry organisations argued that, in the interest of consumer protection, risk insurance products should not be exempted from commission disclosure requirements.

5.153 At hearings, the ACA's Ms Petschler emphasised that 'commission disclosure is a critical tool in improving transparency and raising consumer confidence in the financial market generally'.[178] The trigger for disclosure requirements in the legislation is whether commissions have the power to influence an adviser making a sale. In relation to disclosure of commissions on risk products the ACA observed that:

> While the argument is that commissions on risk products do not affect returns to consumers, we sincerely believe that the decision of agents to recommend one type of policy or one type of provider over another is influenced by commissions and can be influenced by commissions, and we are keen to make sure that consumers have adequate information to be able to assess the independence or otherwise of the advice they are receiving and to get the full information on the costs of the products that they are purchasing.[179]

5.154 The Consumer Credit Legal Service submitted that while a good agent may choose an insurance product based on its value to the consumer, and not on the agent's remuneration, it would be difficult for agents to resist higher commissions on some products.[180] ISFA agreed, pointing out that, in relation to risk products, high up-front commissions on product sales and 'volume bonuses' encourage agents to sell new products over servicing existing ones, and so should be disclosed to consumers.[181]

---

176 Statutory Oversight of ASIC, Committee Hansard, pp. 76–77.

177 Committee Hansard, p. 77.

178 Committee Hansard, p. 56.

179 Committee Hansard, p. 56.

180 Submission no. 41, p. 3.

181 Supplementary Submission no. 29A, pp. 2–3.

5.155 The Consumer Credit Legal Service concluded—with the life agents—that disclosure of commissions will provide an incentive for insurance companies to reduce commissions. It saw, however, that the end result would be a lower product price for consumers.[182] IFSA, meanwhile, dismissed ‘small business doomsday’ scenarios, predicting that multi-agents will not survive the new regime. It submitted that while there are challenges in change, those businesses that rise to the challenges will, at the very least, retain their value.[183]

5.156 In this regard, Ms Petschler advised that the disclosure regime could actually benefit life agents. She noted that they could use disclosure documents to explain how commissions affect the price of a product sold by them compared with that sold by the salaried officers of large life offices, and could also advertise the additional services the agent provides.[184] She also saw that any concentration of influence in the marketplace by product manufacturers should be addressed through ‘different regulatory structures and the intervention of regulators in the market place’.[185] She concluded that the consumer movement is confident that the implementation of the commission disclosure will increase competition and that consumers will get a better deal as a result.[186]

5.157 At hearings, Miss Lynn Ralph, CEO of IFSA, agreed that ‘consumers will have increased confidence in the industry if they think nothing is hidden’. Miss Ralph supported full disclosure of fees and margins ‘along the value chain’ from manufacturer to distributor, with the qualification that disclosure of product margins may be unhelpful; given it is not understood how influential price is for consumers when buying a range of financial services. She noted that IFSA intends to research this later in the year.[187]

5.158 Asked about the possibility of exempting risk insurance agents from disclosure requirements, ASIC advised the Committee that it is arguable, under the present drafting of the legislation, that a provider may gain exemption if it could be proved that commissions in no way influenced their promotion of a particular product over another. Mr Ian Johnston, Executive Director, Financial Services Regulation, emphasised, however, that suggestions that tied agents would be exempt from disclosure requirements was not borne out by examination of the legislation.[188]

182 Submission no. 41, p. 3.

183 Supplementary Submission no. 29A, p. 3.

184 Committee Hansard, p. 57.

185 Committee Hansard, p. 60.

186 Committee Hansard, p. 60.

187 Committee Hansard, pp. 126; 124.

188 Committee Hansard, p. 358.

Pressure selling

5.159 Consumer organisations were unified in their concerns that the Bill does not go far enough to control pressure selling of financial products, particularly when the sale is not face to face, that is, when it is conducted over the telephone or through telemaketing, internet, direct mail or by other sales methods.

5.160 In its submission, the ACA suggested that the Bill should provide ASIC with wider powers to prohibit unsolicited telemarketing, and 'step in' powers to intervene when other pressure selling techniques emerge in the market place.[189] In recommending a stronger role for ASIC, Mr Connolly advised the Committee that the ACA's object was not to create an over regulated industry where legal action, which would be expensive and protracted, was the consumer's main recourse.[190] Instead, the ACA wanted consumers to be better informed about financial service products and to exercise choice:

> where it is their decision to go and consider financial services products, to get a financial plan, and they are not in a pressure situation where someone has visited them at home or in the workplace or contacted them on the telephone when they are trying to get the kids to bed…[191]

5.161 At this stage, however, the ACA judged that the Bill did little to support this development or to protect consumers, especially low income consumers, from unconscionable conduct.[192] The ACA, with the Financial Services Association, were particularly concerned about the failure of the legislation to address the growth in pressure selling of superannuation products over the telephone, especially given the implications of the Government's proposed choice legislation.[193]

5.162 At hearings, the Department of the Treasury's Ms Vroombout explained that the prohibition on cold calling was limited to unsolicited meetings with another person because that was the situation in which the consumer has least control. She also advised that the legislation is an attempt to balance consumers' needs while not unduly limiting the marketing of products.[194]

Disclosure of ethical investment policies

5.163 A number of organisations and individuals asked that the Bill's disclosure regime should require declaration of non-financial considerations in investment decisions. In particular, submissions requested that disclosure obligations for a

189 Submission no. 44, p. 10.

190 Committee Hansard, p. 75.

191 Committee Hansard, p. 75.

192 Committee Hansard, p. 75.

193 Committee Hansard, p. 56, and see ACA Submission no. 44, p. 10; FSCPC Submission no. 37, pp. 4–5.

194 Committee Hansard, p. 304.

financial product with an investment component require that the seller or issuer should, at the point of sale, disclose to the retail client:

> The extent (if at all) to which environmental, social or ethical considerations are taken into account in the selection, retention and realisation of the investments.[195]

5.164 The Australian Conservation Foundation and the Ethical Investment Association (EIA) appeared before the Committee to explain how socially responsible investment (SRI) or ethical investment disclosure fits within the new disclosure requirements laid down by the Bill.

5.165 The Australian Conservation Foundation argued that ethical disclosure at point of sale is essential to provide consumers with 'sufficient information to make informed decisions' about acquisition of financial products, as required by the Bill. Mr Michael Kerr explained that the proposed requirement should apply to all collective products, such as superannuation, which are overseen by a fund manager.[196] The organisation, along with the EIA, discounted suggestions that what is 'ethical' cannot be legislated on, arguing that the term must be open ended to allow for diversity of focus.[197]

5.166 These organisations also reported that their proposal is made in recognition of growing demand for ethical investment products in Australia and overseas. In its submission the EIA reported that:

- a KPMG survey conducted in mid 2000 revealed that 69 per cent of Australians would consider a socially responsible investment fund if given the opportunity; and
- the United Kingdom now requires pension trustees to disclose their policy on socially responsible investment.[198]

5.167 At hearings, the Australian Conservation Foundation also reported that ethical investment has grown by 50 per cent in the United States and the UK during the past decade, with the equivalent of $4.05 trillion currently invested in the USA. Mr Kerr stated that one billion dollars is currently in ethical investments in Australia, with mainstream financial institutions such as Westpac, AMP, Rothschild and the Commonwealth Bank participating.[199]

5.168 However, in a report on SRI in Australia (prepared by the Allen Consulting Group and tabled by the Ethical Investment Associations on 14 June) the Australian

---

195 See for example, Submissions nos 44, 68, and group Submission no. 69.

196 Submission no 22, pp. 3–4, and Committee Hansard, p. 49.

197 See ACF Committee Hansard, pp. 49–50, and EIA Committee Hansard, p. 245.

198 Submission no. 68, pp. 1–2.

199 Committee Hansard, pp. 46–47.

market was judged to be slow to take up ethical investment, with the present sector seen as 'immature and fragmented'.[200] The EIA explained at hearings that, despite consumer and investor interest, the majority of investment managers are not responding to demands for disclosure of the nature of investments being made.[201]

5.169 For this reason, the representatives of the EIA submitted that the ethical disclosure requirement should be included in the legislation, rather than left as a marketing tool.[202] Mr David Andrews of Glebe Asset Management advised that ethical disclosure requirements would also provide an opportunity to secure a more transparent ethical investment market, as managers at present can be 'very thin' on explanations of their investment methodology.[203]

5.170 The introduction of an ethical disclosure clause was supported in principle by other organisations including CPA Australia and the AMP Limited. However, they also cautioned the Committee that the inclusion of such a clause might be counterproductive to the purposes of the Bill, or have potential negative effects for consumers.[204]

5.171 In this regard, ISFA told the Committee that it did not support the introduction of any measures that would move the legislation back towards the more prescriptive regimes under which we currently operate. Miss Ralph considered that the inclusion of specific disclosure requirements may actually disadvantage consumers if every organisation was made to make a statement, as against a market situation where those companies with genuine claims would advertise the fact.[205]

5.172 The AMP, which has launched its own SRI fund, agreed, also cautioning that differences in the superannuation industry between that in the UK and Australia made legislating for ethical investment disclosure requirements inappropriate in the context of the Bill. It recommended that the issue should be taken forward after consultation with the investment community.[206]

Superannuation

Introduction

5.173 In its submission, the Association of Australian Superannuation Funds of Australia (ASFA) observed that the treatment of superannuation as a 'financial

---

200 *Socially Responsible Investment in Australia*, A report prepared by the Allen Consulting Group for the Ethical Investment Working Group, 2000, p. 2.

201 Committee Hansard, p. 248.

202 Committee Hansard, p. 248.

203 Committee Hansard, p. 249.

204 CPA Committee Hansard, pp. 39–40, and AMP Submission no 49, p. 3.

205 Committee Hansard, p. 122.

206 Submission no. 49, pp. 3–4.

product' under the Bill poses special challenges. This is because of the distinctive nature of Australia's superannuation industry: it is a compulsory system based on long term investment (normally preserved until retirement) and has many financially unsophisticated investors.[207]

5.174 ASFA saw problems for the superannuation industry arising from the present definition of financial advice. It noted that, particularly under proposed choice of funds legislation, employers may be seen to be giving 'financial advice' to employees about their superannuation arrangements, and so would fall within licensing requirements.[208] ASFA also warned that licensing requirements relating to training and competency may undermine member representation on trustee boards; an important consumer and prudential safeguard which ensures fund members' long-term interests are adequately represented.[209]

5.175 At present, the standards for the operation of superannuation funds and the behaviour of trustees are currently set through the *Superannuation Industry (Supervision) Act 1993* [the SIS Act]. A number of organisations making submissions to the inquiry expressed concern that present satisfactory arrangements established by the SIS Act will not be continued under the new regime; or that attempts to regulate superannuation under the Bill may prove less than efficient.

5.176 The Institute of Chartered Accountants in Australia and CPA Australia feared that the inclusion of disclosure requirements for superannuation under the Bill will be a 'dilution of the complete package approach' under the SIS Act. They predicted that compliance costs will increase.[210] The Corporate Super Association was concerned that the distinction made under the SIS Act between 'not-for-profit' and public offer superannuation funds is not carried into the new regime.[211]

5.177 Accordingly, ASFA advised the Committee that the new regulation framework should seek to ensure that its standards are enforced in a consistent way, and do not result in or require a duplication of effort or an increase in costs for complying funds. At the same time, the reforms should proceed without any diminution of existing consumer protection for fund members. It concluded that: 'Superannuation cannot and should not be simplistically equated with other managed investments'.[212]

5.178 In this regard, Dr Michaela Anderson, Director of ASFA, recommended that the present Bill should clearly recognise the current dispute arrangements outlined

---

207 Submission no. 16, pp. 7–8.

208 Submission no. 16, p. 14.

209 Submission no. 16, p. 16.

210 Submission no. 40, p. 3.

211 Submission no. 60, pp. 2–3.

212 Submission no. 16, p. 7, and see Committee Hansard, p. 191.

under the SIS Act. ASFA wanted the superior regulatory powers of the Superannuation Complaints Tribunal Committee (SCTC) preserved as appropriate to superannuation's special nature, and wanted to avoid duplication.[213] Dr Anderson noted that it may be necessary to broaden the SCTC's powers to address any identified jurisdictional problems. ASFA also supported any requirement for superannuation licensees to hold trustee liability insurance to comply with the Bill.[214]

5.179 In addition, Dr Anderson emphasised the importance of the disclosure requirements for superannuation products. She advised the Committee that these requirements should be devised in full recognition that superannuation is compulsory and that many fund members are financially unsophisticated. Dr Anderson reported that ASFA considers that the details of the disclosure requirements should be set down in the regulations, and should be formulated with the consumer in mind. She advised that ASFA, which had conducted consumer research, could offer valuable assistance in this regard.[215]

5.180 At hearings on the 27 June 2001, the Department of the Treasury confirmed that coverage of superannuation funds under the Bill is significantly dependent on the choice of funds legislation. Two sets of regulations are presently being drafted to deal with the possibility that the choice legislation will not be passed.[216]

Retail/wholesale distinction relating to superannuation products

5.181 A key distinction in the legislation is that between the provision of financial products on a 'wholesale' or 'retail' basis. The ruling that 'all superannuation products are retail' activates the requirement for full disclosure to the consumer. While this aspect of the legislation was generally approved, some organisations identified unintended consequences which they judged may have negative effects for the superannuation industry or for consumers.

5.182 In its submission, ASFA strongly supported the Bill's distinction and the provisions declaring that all persons issued superannuation products and Retirement Savings Account (RSA) products are retail clients in all circumstances. ASFA was concerned, however, that the legislation remains unclear on whether related products, such as allocated pensions or annuities which may be offered by life offices, are included in the definition of superannuation product. It recommended that all such products should be considered retail for the purposes of those provisions of the Bill.[217]

5.183 The Australian Consumers Association also stressed its support for the provisions that bring superannuation products under the retail category. It emphasised

---

213 Committee Hansard, p. 195.

214 Committee Hansard, p. 193.

215 Committee Hansard, p. 193.

216 Committee Hansard, pp. 272–73.

217 Submission no 16, p. 12.

that the possible introduction of superannuation 'choice' legislation makes it 'critical' that:

> …strong disclosure, selling practices, cooling off, compensation and enforcement provisions are established for all clients in superannuation to ensure Australian consumers have protection against mis-selling and abuses which have emerged in other markets…such as the UK and Chile, with disastrous individual and public policy results. [218]

5.184 In this regard, the ACA urged that the Government should 'carefully review' any exemptions which would deem certain transactions 'wholesale', and so outside the retail disclosure requirements. A particular area of concern related to the 'product value test'—where retail disclosure requirements on investment transactions over a specified amount would be waived on the assumption that investors are 'sophisticated'.[219]

- *product value test exemptions*

5.185 ASFA, the Institute of Chartered Accountants in Australia and CPA Australia were in agreement that the Bill's 'product value test' exemptions, proposed under the definition of retail client, could cause many inexperienced investors to lose the benefits of retail client protection.[220] These concerns were also shared by consumer interest organisations such as the Financial Services Consumer Policy Centre and the Australian Consumers Association (ACA).[221]

5.186 As foreshadowed in the Explanatory Memorandum to the Bill, the 'product value test' is likely to be set at $500 000, consistent with the Corporations Law. As ASFA has noted, the threshold of the test in Corporations Law has existed for many years and has not been indexed.[222] Submissions argued that the value test threshold therefore does not respond to the present superannuation profiles of many retirees, many of whom will retire with a lump sum exceeding the test amount. This means that many unsophisticated investors will be vulnerable, through not being adequately informed, or being misinformed, about their post superannuation investment choices.[223]

5.187 To address the problem, it was suggested that the threshold level of the product value test should be raised to ensure most consumers receiving lump sum payments are covered; or, that the product value test be removed.

---

218 Submission no. 44, p. 14.

219 Submission no. 44, pp. 14–15

220 Submission no. 16, p. 13 and Submission no. 40, p. 3.

221 Submission nos 37 and 44, and see Committee Hansard, p. 58.

222 Submission no. 16, p. 13.

223 ASFA, Institute of Chartered Accountants and CPA Australia, ACA and Financial Services Consumer Policy Centre. See submission nos 16, p. 12; 40, p. 3; 44, p. 15; and 37, p. 6.

5.188 The ASFA and the Financial Services Consumer Policy Centre proposed that the test value could be set at the pension Reasonable Benefits Limit (indexed and currently at just over one million dollars).[224] They advised caution, however, with ASFA warning of possible unintended consequences if superannuation funds using related unregistered unit trusts are treated as 'retail clients'.[225]

5.189 In relation to the removal of the exemption, ASFA and the ACA noted that the Bill separately provides an exemption for high wealth individuals to be treated as wholesale clients, subject to certain tests, if they request it. [226] In this context, ISFA advised that the professional investor test should apply for superannuation purposes, as it would pick up trustees and others who control significant funds and who are 'genuinely wholesale'.[227]

- *status of pooled superannuation trusts*

5.190 However, the Committee was also lobbied by other groups who saw inefficiencies arising from the Bill's treatment of *all* superannuation products as retail when some, it was argued, are genuinely wholesale. The point at issue was the Bill's application to pooled superannuation trusts (PSTs). PSTs are unit trusts with a corporate trustee that operate as investment vehicles for other superannuation funds. As superannuation entities they are required to meet SIS Act conditions and so would be defined as 'retail' under the new legislation.[228]

5.191 The capturing of PSTs under the retail distinction was widely criticised. In evidence to the Committee, IFSA asserted that the Bill is in fact 'seriously flawed' in this respect. It stated:

> While IFSA would not query the desirability of treating as retail, advice and dealings by small superannuation funds and individual consumers with substantial funds (eg. retirees with over $500 000 to invest), we believe that significant problems and inefficiencies will arise from treating genuine wholesale transactions this way.[229]

5.192 The AMP noted in its submission that, for the past 15 years, PSTs have been regulated as investments offered to wholesale or sophisticated investors. By way of example, the AMP reported that the AMP Henderson Pooled Superannuation Trust currently has a minimum initial investment of $1 million per investor.[230] The BT Financial Group explained that investments in PSTs can only be made by trustees of

224 Submission no. 16, p. 13 and Submission no. 37, p. 6.

225 Submission no. 16, p. 13.

226 Submission no. 16, pp. 12–13; and Submission no. 44, pp. 14–15.

227 Committee Hansard, p. 123.

228 Supplementary Submission no. 16A, p. 1.

229 Submission no. 29, p. 3.

230 Submission no. 49, p. 2.

regulated superannuation funds or approved deposit funds; trustees who have already satisfied the Australian Prudential Regulatory Authority (APRA) of their financial acumen. It also noted that these same trustees, if investing in self-managed investment schemes, would be treated as 'wholesale'.[231] The AMP, Freehills, and the BT Financial Group agreed that genuine wholesale investors should not be treated as retail, and that there should be a carve out for 'professional' and 'sophisticated' investors, such as trustees investing in PSTs.[232]

5.193 The BT Financial Group and IFSA also saw that 'significant problems and inefficiencies' for PSTs would result under the present legislation.[233] The Institute of Chartered Accountants in Australia and CPA Australia predicted that additional complexity, with some funds being treated as wholesale clients and others as retail, will result in a lowered adherence to disclosure standards and an increase in costs.[234]

5.194 The Chartered Secretaries Australia added that the retail requirement may also prevent some otherwise useful products being released in the PST format because of the stringency of retail disclosure requirements, compared with those for a sophisticated investor. The organisation noted that PST products were created, in the first instance, to service the needs of the sophisticated investor.[235]

5.195 In a supplementary submission, ASFA gave consideration to the position of PSTs. It observed that, under the present drafting of the Bill, wholesale exemptions could not be obtained for PSTs, even if the funds held were in excess of $10 million. ASFA concluded that, given the high value investment involved, to subject PSTs to retail requirements would be 'an unnecessary protection generating unwarranted costs and complexity'.[236]

5.196 ASFA recommended that the current Corporations Law 'professional investor' exemption for superannuation funds with assets in excess of $10 million, when these funds are invested in pooled superannuation trusts, should be retained. It considered, however, that smaller funds with assets less than that amount when investing in PSTs should retain retail clients status.[237]

- *Government response on wholesale/retail issues*

5.197 In his letter of 25 June to the Chairman of the Committee, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, indicated that proposed amendments to the Bill will ensure that 'the retail/wholesale distinction works

---

231 Submission no. 45, p. 2.

232 Submission nos 49, p. 2; 54, p. 6; 45, p. 2.

233 IFSA Submission no. 29, p. 3, supported by BT Financial Group Submission no. 45, p. 2.

234 Submission no. 40, p. 3.

235 Submission no. 65, p. 6.

236 Supplementary Submission no. 16A, p. 2.

237 Supplementary Submission no. 16A, p. 2.

appropriately in relation to superannuation products'.[238] At hearings in Canberra on 27 June, the Department of the Treasury confirmed the Minister's intention, advising, however, that issues relating to the product value test and to the treatment of PSTs will be addressed in the regulations currently being drafted by the Department.

5.198 In relation to the product value test, Ms Vroombout told the Committee that the Department envisaged that the regulations would specify that a different product limit for superannuation pay-outs should apply. She also advised that superannuation associations' suggestions that the Reasonable Benefit Limit should be adopted would certainly be considered in the drafting.[239]

5.199 Ms Vroombout also told the Committee that the Department had received representations relating to PSTs and was considering its options; such as whether the disclosure requirements should apply to dealings of a pooled super trust with other superannuation funds, or whether the professional investor test should be applied.[240]

Exemptions for 'not-for-profit' superannuation funds

5.200 A number of organisations protested that the new requirements for treatment of not-for-profit superannuation funds were inappropriate. The organisations noted that the SIS Act provides distinct and separate regulation for not-for-profit, as against public offer schemes, and argued that this distinction should be maintained under the new regime, or that an exemption should be provided for some schemes, as for self-managed superannuation funds.

5.201 Freehills argued that the present legislation was not intended to cover not-for-profit funds, which are better catered for by the provisions in the SIS Act. The firm noted that the recommendations for the uniform regulation of the financial sector in the Financial System Inquiry (Wallis) Report do not naturally apply to the operations of not-for-profit funds.[241] Freehills further judged that the application of the proposed licensing regime to not-for-profit funds seems to be based on the flawed perception that these funds were required to be licensed under the SIS Act, which is not the case.[242]

5.202 In their submissions, the Corporate Super Association and Freehills explained that while public offer funds fit comfortably under the definition of financial product, as defined by the legislation, this is not the case for not-for-profit funds.[243] Freehills defined not-for-profit funds as:

---

238 Document tabled on 25 June 2001, p. 2.

239 Committee Hansard, p. 298.

240 Committee Hansard, p. 272.

241 Submission no. 54, p. 2.

242 Submission no. 54, p. 3

243 Submission nos 60, p. 1 and 54, p. 1.

- corporate funds operated solely for the employees of a particular employer; and
- industry funds operated for the employees of employers within a given industry.[244]

5.203 The Corporate Super Association clarified the definition, noting that there are differences between industry funds and corporate funds, but that both these types of funds have board trustees structured to comply with the equal representation rules set by the SIS Act, and are defined as 'not-for-profit'.[245]

5.204 In its submission, the Association further explained that trustee arrangements in not-for-profit funds are not equivalent to those in commercially oriented public offer funds. Many use a representative trustee structure, where non-expert trustees are elected to play a governance role, administering the fund and monitoring the activities of experts appointed to make investment decisions.[246] The schemes are designed to build appropriate incentive and benefit structures for employees and do not involve payment of commissions or fees.[247]

5.205 At hearings on 25 June in Canberra, the Chairman of the Corporate Super Association, Mr Mark Cerche, told the Committee that management costs in the corporate funds sector are at a ratio of approximately 0.7 per cent of the $120 million plus funds managed. The equivalent management expense in a publicly offered fund would be in excess of 1.4 per cent.[248] In addition, he emphasised that other than 'sitting fees' of perhaps $500 a year, corporate board trustees are not paid employees of the fund and are not licensed to give investment advice.[249]

5.206 The Church Superannuation Funds Cooperation Committee reported that the representative structure allows members a greater role in management of the funds, building confidence and contributing to a very low level of complaint.[250] The Corporate Super Association also reported a lack of history of abuse of the fiduciary relationship or serious compliance breaches amongst major corporate funds. It noted, instead, that serious breaches and frauds have occurred where a 'professional' trustee, adviser or administrator has been at fault.[251]

---

244 Submission no. 54, p. 1.

245 Corporate funds function with employer, rather than union, support and offer members defined benefit schemes, while industry funds offer accumulation benefits. See Committee Hansard, p. 263. The SIS Act equal representation rules require that half of the trustees are elected by the employer and half are elected on behalf of members.

246 Submission no. 60, p. 3.

247 Submission no. 60, p. 1.

248 Committee Hansard, p. 254.

249 Committee Hansard, pp. 259; 260.

250 Submission no. 67, p. 2.

251 Submission no. 60, p. 3.

5.207 In evidence to the Committee in Sydney on 14 June, ASFA's Director Dr Anderson explained that, while not licensed by ASIC, non-public offer fund trustees have to demonstrate their adherence to 'onerous requirements' set down by the SIS Act. She reported:

> Trustees are required to have both their financial statements and compliance with SIS audited on an annual basis and are subject to reviews by APRA. The consumer protection requirements of SIS include: disclosure requirements at fund entry, annually on significant events, at exit and on request; and access to internal and external complaints mechanisms. Equal representation on trustee boards is a consumer protection measure and also, it is often argued, a prudential measure. SIS provisions which disqualify persons convicted of dishonest behaviour for being trustees or investment managers, the covenants at section 52 and standards relating to records, accounts and all other issues are as much consumer protection as about prudential regulation.[252]

5.208 Given this, there was agreement in the evidence that the new regime could impose an additional, and yet unproductive, layer of regulation on corporate funds that would increase costs and impair functioning administrative structures. The end result, organisations argued, would be a reduction in the number of not-for-profit funds.

5.209 The Corporate Super Association advised the Committee that if capital adequacy is a criteria for holding a license then the Bill will knock 'dead' the corporate superannuation industry.[253] It predicted that employers would cease to provide corporate funds, choosing to meet only minimal Superannuation Guarantee Act requirements through public offer funds, with a resulting greater reliance on Government pensions.[254] The Institute of Chartered Accountants of Australia and CPA Australia also observed that, if funds were to comply with licensing requirements, the costs of appointing a licensee to advise staff would have to be borne by fund members.[255]

5.210 To correct the situation, ASFA recommended that all SIS Act regulated complying non self-managed superannuation funds should be treated the same as existing licensees for the purposes of the new regime. This means that trustees should be able to obtain an Australian financial services licence to cover their existing activities through the making of a declaration.[256]

5.211 The Corporate Super Association asked that a specific exemption should be made under the licensing regime for not-for-profit funds. In its submission the

252 Committee Hansard, p. 192.

253 Committee Hansard, p. 256.

254 Submission no. 60, p. 3.

255 Submission no. 40, p. 4.

256 Committee Hansard, p. 192.

Association, along with Freehills, also recommended that the distinction in the SIS Act between not-for-profit and public offer funds should be retained.[257] The Church Superannuation Funds Cooperation Committee asked that church funds be exempted from the licensing requirements in the same way as self-managed funds; that is, within the legislation itself, and not in the regulations. The CSFCC also requested market testing of disclosure requirements. [258]

5.212 William M Mercer Pty Ltd agreed that 'there is a strong justification to exclude the trustees of employer sponsored superannuation funds from the licensing… requirement' under the Bill.[259] Alternatively, it saw that if not-for-profit funds are to come under the purview of the Bill, there is a need to provide a specific exemption for superannuation trustees like that provided for dealers in securities under the Corporations Law. Mercer suggested that the exemption should allow fund trustees wishing to outsource to do so without a licence, where dealing activities are for the administration and management of fund assets. Mercer did not support, however, any exemption for not-for-profit funds from the disclosure regime.[260]

5.213 At hearings in Canberra on 27 June, Ms Vroombout of the Department of the Treasury told the Committee that capital adequacy would not be an issue for corporate superannuation funds as they are regulated by APRA.[261]

5.214 In relation to the situation of superannuation board trustees, Ms Vroombout stated that, to address concerns, the Bill's amendment on multiple trustees had been introduced to allow for competencies to be held collectively among trustees on superannuation boards.[262] She stated that outsourcing is not outlawed by the Bill, and that the competency of trustees would stand on whether they gave financial advice or not. Their status in this respect would be determined on a collective basis by ASIC.[263]

5.215 ASIC confirmed this interpretation, reporting that, as articulated in its policy paper, it would adopt 'flexible minimum standards' in assessing the competency requirements of trustee boards.[264]

5.216 Ms Vroombout of the Department of the Treasury also advised the Committee that until the commencement of choice of fund legislation, corporate superannuation funds would be exempted from the operation of the Bill by a regulation.[265]

---

257 Submission no. 54, p. 3.

258 Submission no. 67, pp. 5; 2.

259 Submission no. 28, p. 1.

260 Submission no. 28, pp. 4; 1.

261 Committee Hansard, p. 290.

262 Committee Hansard, p. 290.

263 Committee Hansard, p. 291–92.

264 Committee Hansard, p. 329.

265 Committee Hansard, pp. 272–73.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

Support for the Bill

6.1 The Committee concludes that the Financial Services Reform Bill 2001 has been generally well received by the financial services industry. In particular, the Committee notes that key stakeholders are satisfied with the main objectives of the Bill. The Committee also concludes that the consultation process with interest groups, which preceded the final Bill, was appropriate and effective. The Committee accepts that there are problems with a number of aspects of the Bill, but that these do not affect overall acceptance of the Bill. The Committee therefore **recommends** that the Bill be passed.

Concerns about the process

6.2 The Committee concludes that certain reservations expressed about the Bill are justified because the full nature of its operation cannot be known until the Australian Securities and Investments Commission (ASIC) releases its policy papers, and the Department of the Treasury has finished drafting the regulations.

6.3 The Committee also endorses concerns that the tight timeframe allowed for finalising the actual legislation and the regulations will not allow affected sectors to participate fully in the drafting processes.

6.4 The Committee is sympathetic to concerns that lack of detail in the Bill might place too great a degree of responsibility on ASIC to interpret the legislation, thus leading to reduced certainty about the Bill's operation. The Committee concludes that ASIC's resources are already stretched and any further responsibilities stemming from the current Bill would require additional funding.

6.5 The Committee accepts that another concern for industry participants is the timeframe for the transitional arrangements for the move to the new financial regime. The Committee acknowledges some industry unease about ASIC's expectations that industry can meet requirements, including the establishment of mechanisms for self-regulation, within the expected timeframe.

6.6 The Committee concludes, however, that many of these concerns will have been allayed by the 5 April 2001 statement by the Minister for Financial Services, the Hon Joe Hockey MP, that the commencement date of 1 October 2001 for the new regime is simply the date on which persons may comply with the new regime if they wish. Those who need more time to comply will generally have up to 1 October 2003.

6.7 The Committee acknowledges the desirability of commencing the new regime as soon as possible, but **recommends** that the two year transitional period be retained in order to assist those in the financial services industry to comply with the new

regime. The Committee also **recommends** that the Government explore the possibility of additional funding for ASIC to allow it to meet its new responsibilities.

Revoking of the media exemption

6.8 The Committee received substantial evidence from media organisations that the imposition of the Bill, in absence of the exemption provided under the Corporations Law, will impose real operational difficulties on the media. These in turn would fundamentally challenge information providers' ability to fully inform consumers on the threshold of financial reform.

6.9 The Committee notes the Minister's statement that there was no intention that the Bill should change the practical effect of licensing requirements for media organisations. In this respect, the Committee observes that the media has no quarrel with the requirement that those paid to deliver financial advice, by whatever medium, should be subject to the Bill's licensing requirements. Instead, its concerns focus on the perceived threat to the independent provision of information about financial services, which would run counter to Australia's commitments under the World Trade Organisation's General Agreement on Trade in Services (GATs).

6.10 The Committee therefore considers that revoking the media exemption, without other adequate provisions being in place under the Bill, will have unintended consequences for Australia's media providers and for consumers, and may have broader ramifications for Australia in an international context. In this regard, the Committee notes the Minister's commitment, in his letter to the Chairman of 25 June, that a regulation will be cast, after consultation with the industry, to ensure that the media will be exempted under the definition of general advice, subject to certain disclosure requirements.

6.11 The Committee recognises that this was intended to give media organisations the same degree of certainty to that provided previously under the Corporations Law. However, the Committee is persuaded by evidence that the matter should be addressed in the legislation, and not in the regulations. The Committee therefore welcomes the Minister's further public commitment that the legislation will be amended so that media organisations regain the certainty provided by the Corporations Law exemption.

6.12 The Committee **recommends** that Bill should be amended as follows to provide that result:

(1) A media provider is not required to obtain an Australian Financial Services Licence for a prescribed publication which contains:

a) general advice; or

b) personal advice, unless:

(i) the media provider carries on the business of providing personal advice, or

(ii) the media provider's sole or principal purpose is to influence people in making decisions in relation to a particular financial product or class of financial products.

(2) For the purposes of sub-section (1):

media provider means a person who carries on a business with the sole or principal purpose of providing information to the public and includes, without limitation:

(a) a person licensed under the *Broadcasting Services Act 1992*, the Australian Broadcasting Corporation, and the Special Broadcasting Service Corporation;

(b) a publisher of a newspaper or periodical that is generally available to the public, including over the internet;

(c) a publisher of an information service that is generally available to the public by the means of transmission, sound recordings, video recordings or data recordings, or over the internet;

(d) a person who is employed by, or provides services to a person described by (a), (b) or (c) above, as a journalist or commentator.

prescribed publication means a publication made by a media provider in the course of carrying on its business of providing information to the public.

The regulations may contain specific provisions qualifying any of the above meanings.

Telephone tape recording proposal

6.13 On consideration of the evidence, the Committee concludes with industry that the Bill's provisions on this issue have been drafted with slight appreciation of the nature and operational features of the shareholder telephone canvassing industry. The Committee notes that the confidential nature of contacts made during takeovers is considered essential to the bid process, and that the high degree of self-regulation imposed is designed to protect both the client and the seller. The Committee also concedes that the requirement to tape record all communications between targets and bidders in all circumstances may be neither practically nor financially feasible for industry participants.

6.14 In this respect, the Committee sees merit in the Minister's commitment, also articulated in the letter referred to above, that an amendment will be moved to limit the scope of the proposal's application. After amendment, the Bill will require that only calls to retail shareholders during a takeover bid need be recorded.

6.15 However, given the degree of concern expressed about the inappropriateness of the proposal *per se*, the Committee believes that the Government should review the

objectives of the proposal, and consider what alternative approaches would marry better with the present operating features of the industry.

6.16 The Committee therefore **recommends** that the Government should remove from the Bill the provisions relating to the recording proposal and consider other options, such as whether the Australian Securities and Investments Commission (ASIC) could play a role in supporting or monitoring self-regulation in the telephone shareholder canvassing industry.

Issues relating to Australia as an international financial centre

6.17 In its report on the draft Financial Services Reform Bill, the Committee noted that the intention of the Bill was to improve Australia's international competitive position and to enhance its role as an international financial centre. In this context the Committee endorsed a number of recommendations made by the Australian Stock Exchange Limited (ASX), in particular a recommendation to increase the shareholder limit on the ASX from 5 per cent to 15 per cent. The Government subsequently announced that it had accepted this recommendation, but did not accept all of the other matters endorsed by the Committee.

6.18 In relation to the final Bill the Committee accepts again the advice of the ASX that the Bill is deficient as it affects Australia's international competitiveness in an integrated global market. The Committee endorses the ASX position that the Bill does not provide a level playing field in that it fails to facilitate links between the ASX and foreign exchanges, to reduce duplication of legislative requirements or to provide a framework for mutual recognition. The Committee also accepts advice from Morgan Stanley, Dean Witter and Goldman Sachs that concessions in the Bill for the provision of financial services by overseas entities to wholesale clients in Australia are insufficient. The result may be that the Bill will deter overseas financial institutions from providing a full range of services to their Australian corporate clients. The Committee considers that Australia's competitive position and its role as an international financial centre are of critical importance to the success or otherwise of the aims of the Bill. It would be unacceptable if the Bill did not provide the flexible and responsive supervisory framework necessary to achieve these aims.

6.19 The Committee therefore **recommends** that the Bill be amended to address these concerns. In particular, the Committee endorses the view of the ASX that the Bill could provide a better framework for mutual recognition by the use of specific policy directions for the exemption and modification powers in the Bill. The Committee **recommends** that the general objects clause of the Bill (s.760A) and the matters to be taken into account by the Minister before making Australian market licensing decisions (s.798A) or clearing and settlement licence decisions (s.827A), should be amended to include this policy intention.

6.20 The Committee also endorses the views of Morgan Stanley and Goldman Sachs that the territorial jurisdiction of the Bill (s.911D) is very wide and may have adverse unintended consequences; and that the Bill does not include a provision equivalent to s.93(5) of the Corporations Law, under which unlicensed entities may

act through licensees without breaching the dealers licensing regime. The Committee **recommends** that the Bill be amended to remedy these defects.

Issues raised by authorised deposit taking institutions (ADI)

6.21 In its report on the draft Bill the Committee recommended that deposit products offered by ADI should be removed from the definition of financial product. The Committee did this to ensure the viability and level of services of ADI agencies in rural and regional areas, many of which would otherwise be forced to close. In its response to the report the Government undertook that the final Bill would exempt ADI deposit products that are for a term of two years or less and have no management or break fees. The Committee, however, concludes that this concession does not go far enough and that there are fundamental problems with the operation and clarity of the exemption. The Committee concludes that the exemption should apply to all basic deposit products. This would comply with the formal intention of the Government that the Bill should apply flexibly to basic deposit products because they are well understood by retail consumers.

6.22 The Committee concludes that the failure of the Bill to exempt all basic deposit products will lead to increased paperwork and administrative costs, which will be passed on to the consumer. The Committee also concludes that the two year limit for basic products is unnecessary and will not enhance consumer protection. In particular the Committee concludes that the present provision in the Bill will be a disincentive to offer such products in ADI agencies, which in remote areas are more usual than banks.

6.23 The Committee therefore **recommends** that the Bill should exempt from the definition of financial product all simple, well known basic deposit products and related non-cash payment systems. To achieve this the Bill should include an amendment in the same terms as set out in paragraph 2.21 of this report, excluding such products from the definition of financial product.

Issues which affect small business

6.24 The Committee accepted evidence that the Bill may adversely affect small business in relation to two main matters.

6.25 The first of these matters is the disclosure of the quantum of commission on risk financial products. As noted earlier, the Committee identified this as a key issue in its report on the draft Bill, recommending that the requirement be deleted. The evidence received by the Committee during the present inquiry has confirmed this earlier conclusion. The Committee accepts the views of small business operators that there is no consumer demand for this type of disclosure, which could impede legitimate market processes. The Committee rejects formal Government advice that quantum disclosure will help consumers identify the potential influences or conflicts of interest which an adviser may have in recommending a product. Instead, the Committee prefers the view of the small business associations, who advise that cost and service are the most important such influences, not commission. Accordingly, the

Committee **recommends** that the Bill should not require disclosure of the quantum of commission on risk products.

6.26 The second matter is the potential for the Bill to harm the continuing viability of small businesses and to reduce their market value. The Committee concludes that these are genuine and legitimate concerns which should be addressed. The Committee accepts evidence that the Bill appears to be biased in favour of the large providers of financial services, at the expense of small business, who are in direct contact with consumers. This bias is demonstrated in a number of ways. For instance, the Committee concludes that the required disclosure of the quantum of commission at the point of sale will put downward pressure on commissions, to the detriment of small business and the benefit of large operators. The Committee also concludes that the Bill will increase proportional costs more for small business than for large. There also seems to be adverse effects from changes made by the Bill to marketing techniques and to the relationship between principal and agent, affecting the agent's right to work and to receive remuneration. The Committee also accepts that the required training and educational qualifications will impact more severely on small operators. The Committee concludes therefore that unless it is amended the Bill will have adverse effects on small business as opposed to more benign effects on big business.

6.27 The Committee accordingly **recommends** that the Bill be amended to provide that:

a) A licensee may revoke an authorisation without the consent of the authorised representative only if that representative is convicted of serious fraud. This will require an amendment of s.916A(4).

b) A person may be the authorised representative of two or more financial services licensees without the need for consent by each of those licensees. This will require an amendment of s.916C.

c) If ASIC suspends or cancels a financial services licence, each authorised representative of that licensee is deemed to continue to be authorised on the same terms and conditions as existed immediately prior to the suspension or cancellation. Proposed s. 915H of the Bill already appears to give ASIC the power to do this, but the Bill should be amended to make it a formal requirement.

d) If a licensee:

i) becomes an insolvent under administration;

ii) a creditor's or debtor's petition is presented under the *Bankruptcy Act 1966* against the partnership; or

iii) becomes an externally-administered body corporate;

then, notwithstanding any other law, all fees and commissions (including trailing commissions) payable to authorised representatives of the licensee as a consequence of the authorisation, shall continue to be paid to the representative as if the licensee had not become an insolvent, had a petition presented or become externally-administered.

e) If an authorised representative of one or more financial services licensees (the initial licensees), ceases to be the authorised representative of one or more of these initial licensees and instead becomes the authorised representative of one or more other financial services licensees, then all fees and commissions (including trailing commissions) payable to an authorised representative as a consequence of the authorisation or authorisations from the initial licensees, shall continue to be paid to the authorised representative as if the authorised representative were still the authorised representative of the initial licensees.

f) Upon commencement of this Act:

i) all agreements between insurance agents and life insurance companies relating to the retailing of life insurance products shall be deemed to continue in force even though the insurance agent may become an authorised representative;

ii) all fees and commissions (including trailing commissions) payable to agents as a consequence of any agency agreement shall continue to be paid to that agent;

iii) all benefits and contractual obligations relating to agency agreements (including buy-back clauses) shall continue to be enforceable as if this Act had not been passed; and

iv) nothing in this Act shall be deemed to prevent authorised representatives from entering into contracts (which may include buy-back clauses) with life insurance companies for the purpose of selling the products of those companies.

Issues relating to the insurance industry

6.28 The insurance industry raised a number of significant concerns with the Bill, as set out below.

Cooling off period

6.29 The Committee accepts the advice of insurance companies that there are circumstances where the cooling off period of 14 days, during which any financial product may be returned, may be an unnecessary and impractical level of consumer protection. Renewal notices for insurance policies are typically set out at least 14 days before the due date, but the cooling off period starts from the date of renewal or the date of the anniversary. The Committee concludes that existing industry practices

provide a sufficient level of consumer protection and therefore **recommends** that the cooling off period should not apply to insurance renewals for which at least 14 days notice is given.

6.30 The Committee does not accept that the cooling off period should apply only to the initial issue of a product and not to increase an existing holding. In these cases the Committee concludes that such a decision is a separate independent transaction. However, the Committee does accept and **recommends** that in the case of market linked financial products such as managed funds that the foreshadowed regulations should provide for adjustments to the amount repaid to reflect changes in the market.

Compulsory third party (CTP) and workers' compensation insurance

6.31 The Committee concludes that the Bill will have undesirable consequences for the operation of these classes of statutory insurance, which are provided in some States by government entities which will not be subject to the Bill and in other States by private companies to which the Bill will apply. This will result in regulatory complexity and increased costs for the private insurers. The Committee endorses the general unanimity of submissions that each of these classes of insurance should be excluded from the operation of the Bill until regulatory uniformity is achieved in the form of a uniform scheme. The Committee therefore **recommends** amendment of the Bill to provide this exclusion.

Insurance quotes by telephone

6.32 The Committee concludes that the Bill causes unnecessary and costly problems for insurance providers in relation to quotes given by telephone. In particular, the Committee concludes that disclosure requirements provide no appreciable protection for the large numbers of telephone inquirers who only want a quote for competitive purposes. In any event, if the consumer accepts the quote then full disclosure documentation is provided. The Committee accepts evidence that the requirement will put pressure on call centres and rural branches and agencies, increasing the cost of each policy by 5–8 per cent. The Committee **recommends** that the Bill should exclude from disclosure requirements the provision of a quotation alone for a general insurance product.

Travel insurance

6.33 The Committee concludes that the Bill will have adverse consequences in relation to travel insurance. The Committee concludes that some provisions of the Bill are inherently inappropriate for the sale of simple general insurance risk products such as travel insurance, which are inherently different from the investment products for which the Bill appears largely designed. The Bill could result in a breakdown of the distribution structure for these products, which represent a significant proportion of income for travel agents. The Committee therefore **recommends** that the Bill be amended and administrative action taken in line with the industry recommendations outlined earlier in this report.

Prohibition on hawking

6.34 The Committee concludes that there is no need to amend the Bill in relation to the hawking of general insurance products in rural areas. The Committee understands that the Bill permits insurance providers to contact insureds or potential insureds to make an appointment to discuss financial needs. The Committee concludes that personal visits by appointment by insurance providers to insureds is the form of contact most beneficial to consumers in rural areas and that the Bill provides for this.

Issues relating to declared professional bodies

6.35 In its report on the draft Bill the Committee concluded that concerns then expressed about the provisions relating to declared professional bodies were valid. The Government's response to the Committee's report rejected this position on the grounds that, from a consumer perspective, the loss suffered from poor financial advice provided incidentally by an accountant, for example, is no less serious than the loss suffered if the poor advice had been given by a full-time financial adviser. Nevertheless, the Government undertook to clarify the extent to which incidental advice is caught by the Bill.

6.36 The Committee concludes, however, that concerns remain in this area. The Committee accepts that a solicitor engaged to advise on all aspects of a matter in a professional capacity, cannot limit the advice provided to matters of a legal nature, and indeed may be liable for failing to give incidental financial advice. The Committee notes that it is therefore part of a solicitor's duty to provide financial advice in certain circumstances.

6.37 The Committee concludes that the exemption in the Bill for incidental advice does not include financial advice given in this way. Indeed, the Government's response indicates that the Bill is intended to apply to solicitors and accountants who provide incidental financial advice.

6.38 The Committee also concludes that at present few if any professional bodies will seek to be declared for the purposes of the Bill. The Committee endorses this position and questions whether ASIC should divert resources from its core regulatory function to assume responsibilities that could amount to the regulation of the legal and other professions.

6.39 The Committee endorses the concerns of accounting bodies that their members who offer traditional accounting services may come within the Bill.

6.40 The Committee concludes that there are fundamental problems with provisions in the Bill relating both to declared professional bodies and to incidental advice. The Committee **recommends** that the Bill be amended to exclude incidental advice from the requirements of the legislation.

Consumer protection issues

6.41 The Committee appreciates the considered response of consumer representatives on a Bill that aims to benefit consumers. The practical and conceptual issues raised include those addressed by industry associations, as well some additional aspects of the legislation which consumer groups judge may have adverse effects for consumers. The Committee notes that the Government has already addressed a number of these, with mirror provisions being installed under the ASIC Act, and the obligation to fairness reinstated.

6.42 The Committee also considers that it received satisfactory answers to some issues raised in relation to exemptions. In regard to exemptions for bank 'clerks and cashiers' and for those 'acting outside authority', the Department of the Treasury and ASIC explained how the Bill deals with the problems outlined. Similarly, the Committee considers that ASIC satisfactorily resolved issues raised about external dispute resolution mechanisms, and the Department of the Treasury about pressure selling.

6.43 In relation to industry self-regulation and disclosure issues, the Committee concludes that a balance has to be sought between consumer interests and what will benefit industry. The Committee has some sympathy, for example, with the case put by life agents and, as noted above, gave credence to their view that commission disclosure may unduly disadvantage them, while not necessarily benefiting consumers. On the other hand, taking into account consumer representatives' concerns about the role of professional bodies as monitors of compliance, the Committee considers that there may be a need for some finetuning of oversight arrangements by ASIC.

6.44 The Committee therefore considers that ASIC may have to play a more active role in developing guidelines and monitoring industry self-regulation, and **recommends** that consultation with industry and consumer representatives should continue throughout the regime's implementation to finetune that process.

6.45 Finally, while the Committee supports the development of ethical investment as part of the diversification of Australia's investment portfolios, it concludes that the introduction of compulsory disclosure requirements would not be appropriate under the Bill. Instead, the Committee believes that market forces will deliver consumers the most transparent disclosure of socially responsible investment strategies by companies with a genuine commitment to applying them.

Superannuation

6.46 The Committee recognises that the Bill will take the superannuation industry in Australia into a new era, commensurate with its significance as the keystone of Government's retirement policy. Concerns expressed about the adequacy of the Bill to supervise the industry, given its distinctive operation and its objectives, are understandable. However, the Committee believes that the introduction of the single licensing and disclosure regime will advantage and protect consumers.

6.47 In particular, the Bill's key distinction between wholesale and retail investors, and the definition of all superannuation products as retail, is made in recognition of the importance of protecting unsophisticated investors, such as superannuants with lump sums to invest. It is also designed to carve out 'wholesale' or sophisticated investment activities by individuals or large superannuation funds from the disclosure requirements.

6.48 In this regard, the Committee notes the Minister's assurance, in his letter of 25 June, that any perceived anomalies in the wholesale/retail distinction in relation to superannuation products will be addressed. The Committee therefore welcomed advice from the Department of the Treasury that the regulations would address concerns about the Product Value Test threshold. The Committee also heard that the Department of the Treasury was considering its options on the situation of pooled superannuation trusts (PSTs), such as applying the professional investor test.

6.49 The Committee agrees that the treatment of PSTs under the present legislation, in particular, is unworkable and concludes with the Association of Australian Superannuation Funds of Australia (ASFA) that the 'professional investor' test should be applied to PSTs under the new regime. The Committee therefore **recommends** that the current Corporations Law 'professional investor' exemption for superannuation funds with assets in excess of $10 million, when these funds are invested in pooled superannuation trusts, should apply and that amendments should be made to the Bill to that effect.

6.50 On the basis of evidence, the Committee is satisfied that corporate and industry funds will not be adversely affected by the Bill. The Committee notes that corporate funds will not be subject to capital adequacy requirements as APRA-regulated bodies. Concerns about the effect of licensing requirements on superannuation boards of trustees also appear to have been largely addressed by the amendments allowing for competency to be held collectively across the board membership. The Committee concludes that, if fund management expertise is required, then a board member, or contracted expert, should be competent to fill that role. Similarly, if a board trustee or fund representative actually does give product advice, then he or she should be adequately qualified to do so, as required by the regime.

6.51 However, the Committee is aware that the superannuation industry will face challenges in the transitional period where regulation moves from SIS Act regulation to that introduced by the Bill. Industry representatives have commented that the transitional arrangements for the superannuation industry have not been clarified by the Financial Services Reform (Consequential Provisions Bill) 2001.

6.52 The Committee therefore **recommends** that ASIC and the Department of the Treasury should consult with superannuation industry representatives about the best measures to ensure a smooth transition for the superannuation industry into regulation by the Bill.

6.53 The Committee also **recommends** that to facilitate that process, and to ensure ongoing transparency and avoid duplication, the Government should consider preserving the powers of the Superannuation Complaints Tribunal Committee (SCTC) under the SIS Act as the appropriate dispute resolution mechanism for superannuation under the new regime.

Review of the operation of the Bill

6.54 The Committee commends the Government for foreshadowing in the Bill's Explanatory Memorandum that the reforms contained in the Bill will be reviewed by the Treasury, ASIC and CASAC 'after the two year transition period for their implementation.' The Committee, however, notes that as the transition period for the measures in the Bill is two years, it would be only after four or five years have elapsed since the Bill's commencement that the operation of the reforms contained in the Bill could be adequately examined. The Committee therefore **recommends** that, in addition to the foreshadowed review of the Bill's implementation, this Committee conducts a review of the operation of the Bill. The Committee further **recommends** that this second, operational review commence no later than five years after the commencement of the Bill.

APPENDIX 1

SUBMISSIONS RECEIVED

1	Georgeson Shareholder
2	Trustee Corporations Association of Australia
2A	Trustee Corporations Association of Australia
3	Australiawide Realty Pty Ltd
4	Life Advisers Action Group
5	Deutsche Bank
6	Association of Financial Advisers
6A	Association of Financial Advisers
7	Law Institute Victoria
7A	Law Institute Victoria
8	Australian Association of Permanent Building Societies
8A	Australian Association of Permanent Building Societies
9	Australian Surety Association
10	International Banks and Securities Association of Australia
11	Australian Finance Conference
11A	Australian Finance Conference
12	Morgan Stanley Group
13	FSI Consulting Pty Ltd
14	Mr John Fielding
14A	Mr John Fielding
15	Mr Bruce Hamilton
16	The Association of Superannuation Funds of Australia Limited (ASFA)

16A The Association of Superannuation Funds of Australia Limited (ASFA)

17 Financial Planning Association

18 Credit Union Services Corporation (Australia) Limited

19 The Institute of Actuaries of Australia

20 CDM Telemarketing

21 Law Council of Australia

21A Law Council of Australia

21B Law Council of Australia

22 Australian Conservation Foundation

23 Max Harris and Associates Pty Ltd

24 International Banks and Securities Association of Australia

24A International Banks and Securities Association of Australia

24B International Banks and Securities Association of Australia

25 NRMA Insurance Limited

26 Credit Union Services Corporation (Australia) Limited

27 Insurance Agents Association of Australia (IAAA)

27A Insurance Agents Association of Australia (IAAA)

28 William M Mercer Pty Ltd

29 Investment and Financial Services Association Limited (IFSA)

29A Investment and Financial Services Association Limited (IFSA)

30 Australian Payments Clearing Association (APCA)

31 APIR Systems Limited

32 Queensland Association of Permanent Building Societies

33 Goldman Sachs Australia Pty Ltd

34 Australian Financial Markets Association and Securities and Derivatives Industry Association

35 Mallesons Stephen Jaques, Solicitors

36 Clayton Utz, Lawyers

37 Financial Services Consumer Policy Centre

38 The Institute of Chartered Accountants of New Zealand

39 HCF Life Insurance Company Pty Ltd

40 The Institute of Chartered Accountants in Australia and Australian Society of Certified Practising Accountants

41 Consumer Credit Legal Service

42 Insurance Council of Australia

42A Insurance Council of Australia

43 Mr Tony Damian

44 Australian Consumers' Association

45 BT Financial Group

46 Consumer Law Centre of Victoria Limited

47 Securities Exchanges Guarantee Corporation Limited (SEGC)

47A Securities Exchanges Guarantee Corporation Limited (SEGC)

48 National Institute of Accountants (NIA)

49 AMP Limited

50 Murphy Financial Services (SA) Pty Ltd

51 The Australian Institute of Chartered Loss Adjusters (AICLA)

52 QBE Insurance (Australia) Limited and American Home Assurance Company and Transport Industries Insurance

53 ComSuper

54 Freehills

55 One Stop Financial Services

56 Australian Associated Motor Insurers Limited (AAMI)

57 Arlington House Pty Ltd

58 The Securities Institute of Australia

59 Ms Helen Breier, Senior Client Adviser

60 Corporate Super Association

61 GAB Robins Australia Pty Ltd

62 Fairfax Limited

63 National Insurance Brokers Association

64 Australian Travel Agents Co-operative (ATAC)

65 Chartered Secretaries Australia

66 The Australian Federation of Travel Agents

67 Church Superannuation Funds Cooperation Committee

68 Ethical Investment Association of Australia

69 Ethical Disclosure (Group Submission)

70 News Limited

71 Reuters

71A Reuters

72 Consumer Credit Legal Centre (NSW) Inc

73 Mr Ken Phelan

74 Australian Press Council

75 Australian Institute of Company Directors

76 World Vision Australia

77 Dr B Lokuge

78 The Mullum Trust

79 Broadcasters' Submission:

Federation of Australian Commercial Television Stations

Australian Subscription Television and Radio Association

80 SBS Corporation

81 Ms Claire Brunner

82 Ethical Investment Working Group (EIWG)

83 Glebe Asset Management Limited

84 Ms Janice Williams

85 Foster Care Workers (Group Submission)

86 Mr Ian Bowie

87 Commercial Law Firms:

Freehills

Allens Arthur Robinsons

Malleson Stephen Jaques

Blake Dawson Waldron

Clayton Utz

Minter Ellison

Corrs Chambers Westgarth and Deacons

88 Thomas Cook Travel (Australia) Pty Ltd

89 Queensland Law Society Inc

90 Native Forest Network

91 Ms Julianna O'Bryan

92 Westscheme Pty Ltd

93 Australian Stock Exchange (ASX)

94 Combined Insurance Company of Australia

95 State Chamber of Commerce (NSW)

96 Mr Tom Bostock

97 Mr Ray Freeman

APPENDIX 2

WITNESSES AT HEARINGS

<u>**Friday, 27 April 2001, Melbourne**</u>

Law Council of Australia
Ms Kathleen Farrell, Chairman, Corporations Law Committee
Mr Michael Hoyle, Member, Corporations Law Committee

Law Institute of Victoria
Mr Robert Parker, Member, Financial Services Committee

Insurance Council of Australia
Mr Robert Drummond, Executive Manager (Operations)
Mr Dallas Booth, General Manager, Statutory Classes

CPA Australia and Institute of Chartered Accountants in Australia
Ms Kathryn Streeter, Financial Planning Industry Adviser, CPA
Mr Keith Reilly, Technical Adviser, Institute of Chartered Accountants in Australia
Mr Stan Droder, Director, Public Practice, CPA

Australian Conservation Foundation
Mr Michael Kerr, Legal Adviser

<u>**Wednesday, 13 June 2001, Sydney**</u>

Australian Consumers Association
Ms Louise Petschler, Senior Policy Officer, Financial Services

Financial Services Consumer Policy Centre
Mr Chris Connolly, Director
Mr Khaldoun Hajaj, Director of Research

Life Agents Action Group
Mr Paul Maughan, Director

Mr Daryl Foster, Director
Mr Gregory Veivers, Director

Insurance Advisers Association of Australia
Mr Murray Morgan, Chief Executive Officer

Association of Financial Advisers
Mr Joseph Nowak, National President
Mr Dugald Mitchell, Consultant

Murphy Financial Services (SA) Pty Ltd
Mr Michael Murphy, Chief Executive Officer

Investment and Financial Services Association
Miss Lynn Ralph, Chief Executive Officer
Mr Philip French, Senior Policy Manager

Australian Shareholders Association Limited
Mr Ted Rofe, Chairman
Mr David Jackson, Director

Australian Surety Association
Mr Roy Amos, Director
Ms Marianne Robinson, Legal Adviser
Mr Murray Ironfield, Alternate Director

Sydney Futures Exchange Corporation Limited
Mr Malcolm Starr, General Counsel
Ms Patricia Gilligan, Senior Legal Counsel

Financial Planning Association of Australia Limited
Mr Con Hristodoulidis, Senior Manager, Public Policy

Securities Institute of Australia
Mr Malcolm McComas, Member, Markets Policy Group
Ms Peta Lewis, National Policy Adviser

John Fairfax Holdings Limited
Mr Bruce Wolpe, Manager, Corporate Affairs

Special Broadcasting Service
Ms Julie Eisenberg, Head of Policy

Federation of Australian Commercial Television Stations
Ms Julie Flynn, Chief Executive Officer

News Limited
Mr Warren Beeby, Group Editorial Manager

Thursday, 14 June 2001, Sydney

Association of Superannuation Funds of Australia
Mr Bradley Pragnell, Principal Policy Adviser
Dr Michaela Anderson, Director, Policy and Research

CPA Australia and Institute of Chartered Accountants in Australia
Mr Keith Reilly, Technical Adviser, Institute of Chartered Accountants in Australia
Ms Kathryn Streeter, Financial Planning Industry Adviser, CPA

Australian Finance Conference
Mr Ron Hardaker, Executive Director
Mr David Thorpe, Associate Director

Securities Exchanges Guarantee Corporation Limited
Mr Anthony D'Arcy, Manager, Legal Counsel and Company Secretary

Australian Stock Exchange Limited
Mrs Karen Hamilton, General Counsel and Company Secretary
Mrs Paula Kelly, Deputy National Manager, Market Law and Policy

Georgeson Shareholder Communications Australia Pty Ltd
Mrs Maria Leftakis, Managing Director

Westpac Investment Management
Mr Erik Mather, Senior Manager, Institutional Business

Ethical Investment Association
Ms Felicity Wade, Disclosure Project Officer

Ethical Investment Working Group
Ms Sue Mathews, Convenor

Glebe Asset Management Limited
Mr David Andrews, Managing Director

Monday, 25 June 2001, Canberra

Corporate Superannuation Association
Mr Mark Cerche, Chairman
Mr Nicholas Brookes, Chief Executive Officer

Wednesday, 27 June 2001, Canberra

Department of the Treasury
Ms Susan Vroombout, Manager, Product Disclosure Unit, Financial Markets Division
Ms Ruth Smith, Specialist Adviser, Product Disclosure Unit, Financial Markets Division
Mr Ian Beckett, Analyst, Product Disclosure Unit, Financial Markets Division

Australian Securities and Investments Commission
Mr Ian Johnston, Executive Director, Financial Services Regulation
Mr Mark Adams, Financial Services Reform Policy Coordinator
Mr Shane Tregillis, Executive Director, Policy and Markets Regulation
Mr Malcolm Rodgers, Director, Regulatory Policy Branch
Ms Pauline Vamos, Financial Services Reform Policy Coordinator
Mr Peter Kell, Executive Director, Consumer Protection

LABOR MEMBERS MINORITY REPORT

ON THE FINANCIAL SERVICES REFORM BILL

Summary

- The Labor members support the Bill.
- The Labor members agree with the recommendations of the Chair that the 2-year transitional period be retained and that the Government explore the possibility of additional funding for ASIC to allow it to meet its new responsibilities.
- The Labor members recommend that the Bill be amended so that media organisations regain the certainty currently provided by the Corporations Act exemption.
- The Labor members recommend that the Government should remove from the Bill the provisions relating to the recording of takeovers proposal.
- The Labor members do not support the recommendation of the Chair that the Bill should exempt from the definition of financial product all simple, well-known basic deposit products and related non-cash payment systems. The Labor members of the Committee do however, recommend that ASIC take into account the previous conduct and experience of credit unions and building societies in assessing an application for a license.
- The Labor members support the disclosure of commission in all circumstances, and preferably in dollar terms. The Labor members therefore do not support the Chair's recommendation that the Bill should not require disclosure of the quantum of commission on risk products.
- The Labor members are sympathetic to the concerns raised by many of the agents to the Committee and recommend that the Government give further consideration to any situations where an agent may suffer a loss of income or a business asset in the transition from an agent to an authorised representative or licensee.
- The Labor members agree with the recommendations of the Chair in relation to the application of cooling-off periods for insurance products and that there is no need to amend the Bill in relation to the hawking of general insurance products in rural areas.
- The Labor members do not agree with the recommendation of the Chair to exclude from the Bill compulsory third party and workers compensation insurance, nor the recommendation of the Chair to exclude from the disclosure requirements the provision of a quotation alone for a general insurance product.
- The Labor members recommend that the declared professional body provisions be deleted from the Bill. The Labor members are still considering whether an exemption for incidental advice by lawyers and accountants should be restored or the definition of "financial product advice" be appropriately amended.
- The Labor members are still considering whether the amendment proposed by the ACF will be the most effective way to achieve the worthwhile objectives of that proposal.
- The Labor members recommend that section 761G(6) be amended to exclude professional investors and that the SCT be the appropriate dispute resolution mechanism for superannuation under the new regime.
- The Labor members agree with the proposal of the Minister to table regulations exempting not-for-profit superannuation funds from the licensing requirements and certain disclosure requirements under the Bill.
- The Labor members agree with the recommendation of the Chair to review the operation of the Bill.

The Labor members note the objective of this Bill is to realise efficiency gains and costs savings for the financial services industry by "providing a regulatory neutral regime, moving from an industry focus of regulation – with banks being subject to one set of rules, insurance companies another, and so on – to a functional focus of regulation, regulating like activities in like ways regardless of what institution, profession or body is engaged in the activity."[1] This should "encourage increased competition in the industry, lower barriers of entry, reduce costs and provide greater confidence on the part of consumers."[2]

The Bill will also establish a consistent and comparable financial product disclosure regime and ensure that consumers can access appropriate complaint handling mechanisms for resolving disputes with financial service providers.

The Labor members therefore believe that this Bill will enable consumers to make better financial decisions and deliver advantages to business. The Labor members of the Committee therefore support this Bill.

The Labor members of the Committee also support many of the recommendations of the Chair. These include:

- the recommendation that the 2-yer transitional period be retained in order to assist those in the financial services industry to comply with the new regime;
- the conclusion that ASIC's resources are inadequate and the recommendation that the Government should explore the possibility of additional funding for ASIC to allow it to meet its new responsibilities;
- the recommendation to amend the Bill so that media organisations regain the certainty currently provided by the Corporations Act exemption;
- the recommendation that the Government should remove from the Bill the provisions relating to the recording of takeovers proposal;
- the recommendation that the Government should consider preserving the powers of the Superannuation Complaints Tribunal under the SIS Act as the appropriate dispute resolution mechanism for superannuation under the new regime; and
- the recommendation that the operation of the Bill be reviewed by this Committee.

However, the Labor members do not agree, or agree entirely, with all of the recommendations of the Chair and wish to make the following comments.

---

[1] Committee Hansard, pg. 266

[2] Ibid.

General Comments

The Labor members note the remarks of Ms Vroombout of Treasury that the design of this legislation is a "functional approach to regulation".[3] Ms Vroombout further explained to the Committee that "[t]he fundamental framework of the legislation is that it establishes general principles for regulation across the industry with any variance in detailed application to particular sectors being dealt with in the regulation. The broad framework applying across the board is what is in the law. The regulations are the instrument for varying its application, where necessary, to particular activities or bodies."[4]

In this regard, the Labor members note that there is a wide power to make regulations under the Bill and that ASIC has been given extensive powers to modify the application of the legislation.

For example, under section 911A(2)(k) of the Bill, a person can be exempted from the requirement to hold an Australian financial services licence if they provide a service covered by an exemption prescribed in the regulations. The Labor members note an undertaking given by the Minister for Financial Services and Regulation in a speech on 3 July 2001 that "..before the introduction of choice, the Government recognises that lighter touch regulation is appropriate, and only public-offer funds, which excludes most corporate and industry funds, will be subject to licensing under the Bill. This reflects the current situation. Even after choice is introduced, the regime applying to industry and corporate funds will be flexible."

Other examples of the flexibility within the Bill include:

- section 941C(8) which provides that a Financial Services Guide (FSG) does not have to be given to a retail client in the circumstances specified in the regulations;
- section 942B(4) which provides that the regulations may provide that certain information does not have be included in a FSG in a particular situation;
- section 946B which provides that, subject to certain conditions, a Statement of Advice (SOA) does not need to be provided in relation to certain execution-related telephone advice;
- section 947B(4) which provides that the regulations may provide that certain information does not have be included in a SOA in a particular situation;
- section 951B which grants ASIC wide powers to exempt a person from Part 7.7 – Financial Services Disclosure – or to modify the application of the law to that person;

---

[3] Committee Hansard, pg. 266

[4] Committee Hansard, pg. 268

- section 992B which grants ASIC wide powers to exempt a person or financial product from Part 7.8 – Other Provisions Relation to Conduct etc Connected with Financial Products and Financial Services, other than Financial Product Disclosure – or to modify the application of the law to that person or financial product; and
- sections 1020F and 1020G which, respectively, enable ASIC or the Minister (via regulations) to exempt a person or financial product from Part 7.9 – Financial Product Disclosure and Other Provisions relating to issue and sale of financial products – or to modify the application of the law to that person or financial product.

The Labor members also note that the transitional provisions set out in *Financial Services Reform (Consequential Provisions) Bill 2001* provide a further degree of flexibility by allowing most people to transit into the new regime over a 2 year period. The Labor members also note that that Bill provides for insurance multi-agents to apply for a qualified licence, which will allow such agents further time to meet the competency requirements to hold a license.

This flexibility in the legislation should allow Treasury and ASIC to deal with many of the issues that have been raised with the Committee. To that extent, the Labor members extend their appreciation to ASIC for discussing with the Committee their policy proposal papers. The Labor members however regret that they were not able to examine many of the regulations that are proposed to be made under the Bill. The Labor members understand that on 3 August 2001 the Minister for Financial Services and Regulation announced that the regulations would be released in instalments, with the first tranche covering financial markets and clearing and settlement facilities made public in the week beginning 6 August 2001.

The Labor members therefore hope that the implementation of the Bill is thoughtfully considered and the concerns of all stakeholders taken into account. This is particularly important given the large number of people who are likely to be required to be licensed under the *Corporations Act* for the first time. The Labor members would have preferred to have seen all of the draft regulations before reporting on the Bill so as to ensure that the delegated legislation was appropriate.

Specific Comments

Amendments already introduced

The Labor members note that the Government on 28 June 2001 introduced a number of amendments to the Bill, many of which have the support of the Labor members of the Committee. In particular, the Labor members welcomed the amendment to require a financial services licensee to ensure that their financial services are provided efficiently, honestly and fairly. The expression “efficiently, honestly and fairly” is a

much better understood term than "competently and honestly", has been subject to judicial interpretation, and, most importantly, contains a requirement of fairness.

The Labor members also welcome the amendments to the *Australian Securities and Investments Act* in the *Financial Services Reform (Consequential Provisions) Bill 2001* to mirror changes made to the *Trade Practices Act* since responsibility for financial services were removed from the ACCC's consumer protection jurisdiction and given to ASIC.

Deposit Products

The Labor members believe that basic deposit products have already received significant concessions under the new regulatory regime which will minimise any paperwork and administrative costs. The Labor members further believe that there will be significant benefits to consumers from requiring providers of basic deposit products to be competent to provide those services.

The Labor members do not therefore support any recommendation to exempt providers of deposit products from licensing under the Bill by excising deposit products from the definition of "financial product".

The Labor members do however note the concerns of various credit unions and building societies in relation to applying for a licence. The Labor members are aware that the Minister for Financial Services and Regulation said in a speech on 6 October 2000 that "[t]he Government now proposes to provide for a streamlined, fast-track mechanism for registrants or licensees under existing insurance, deposit-taking, securities and future regimes". Nevertheless, the *Financial Services Reform (Consequential Provisions) Bill 2001* does not allows access to streamlined licensing for Approved Deposit-taking Institutions (ADIs).

However, the Labor members also note that the *Financial Services Reform (Consequential Provisions) Bill 2001* does allow ASIC, in considering whether to grant a licence, to have regard to the conduct and experience of an applicant in previously providing the financial services for which the application is made. The Labor members of the Committee recommend that ASIC should consider favourably the previous experience of credit unions and building societies.

Disclosure of Commission and other issues which affect small business

The Labor members of the Committee support the disclosure of commission in all circumstances, and preferably in dollar terms.

The Labor members believe it is appropriate for all consumers when purchasing any financial products – whether an investment product or a risk product – to have all the necessary information to assist them in making their financial decisions. Commission disclosure will improve transparency in the sales and advice process and help consumers identify the potential influences and conflicts of interest which an adviser may have in recommending a product.

The Labor members of the Committee also believe that the requirement for disclosure commission should apply equally to all financial service participants. The Labor members of the Committee believe that there will be very few circumstances – if any at all – where the payment by commission will not influence the provision of advice. The Labor members would be concerned if "tied agents" were to be exempted from the disclosure requirements.

In relation to "other issues which affect small business" raised in the report by the Chair, the Labor members note the concerns raised by many agents of the changes contemplated in this Bill. As discussed above, the Labor members hope that the provisions enabling insurance multi-agents to apply for a qualified licence will assist their transition to the new regime.

However while sympathetic to the concerns raised by many of the agents to the Committee, the Labor members are not in a position at this stage to assess many of the recommendations made by the Chair. For example, the Labor members would not want to alter the priority of payments in the event of a licensee becoming insolvent without obtaining comprehensive advice on the effect of that for Australia's insolvency laws and other creditors of the licensee.

The Labor members do however agree, that the Government should give further consideration to any situations where an agent may suffer a loss of income or a business asset in the transition from an agent to an authorised representative or licensee. Business should not be unjustifiably penalised by a change in legislation altering the modus operandi of their business.

Insurance

The Labor members share many of the concerns of the Chair in relation to the application of the Bill to the insurance industry.

The application of cooling-off periods to products which have a life of less than 14 days, such as some types of travel insurance, needs to be re-examined by the Government. The Labor members also agree with the recommendation of the Chair in relation to the application of cooling-off periods to insurance renewals and to increases in existing holdings.

The Labor members also support the Chair's recommendation that there is no need to amend the Bill in relation to the hawking of general insurance products in rural areas.

The Labor members however, do not agree with excluding classes of statutory insurance from the operation of the Bill. They do however, welcome the push for a national uniform scheme for such classes of insurance.

In relation to the Chair's recommendation to exclude from the disclosure requirements the provision of a quotation alone for a general insurance product, the Labor members are concerned that the provision of a quotation may constitute an implied recommendation but more significantly, may mean that consumers do not receive all the necessary information until too late in their decision making process. A quotation can be assessed only in the context of the circumstances taken into account in making the quotation.

In relation to travel insurance, the Labor members do not support exempting providers of simple insurance products from the requirement to be competent and adequately trained to provide that service. The Labor members also believe that it is important that providers of a financial product disclose all relevant information, including commission, to consumers so that they can make an informed financial decision.

Declared Professional Bodies

The Labor members of the Committee remain concerned that the declared professional body provisions would create a self-regulatory system which is inconsistent with the objective of the Bill. The Labor members of the Committee are also concerned that the declared professional body provisions would be resource intensive for ASIC and for the professional body.

The Labor members therefore recommend that the declared professional body provisions be deleted from the Bill.

The Labor members however, acknowledge the difficulties likely to be caused by the removal of the current exemption from licensing for incidental investment advice by lawyers and public accountants. The Labor members note that there is no history of abuse of that exemption but do not want to create the impression that lawyers should be permitted to operate mortgage investment schemes without being licensed.

Accordingly, the Labor members of the Committee are considering whether the exemption for incidental advice should be restored but the definition of "incidental advice" clarified appropriately. Alternatively, the definition of "financial product advice" or other definitions in the Bill could be amended to clarify what activities of lawyer and accountants it was not intended to be captured by this Bill.

Consumer Issues

A number of issues raised by the consumer groups have subsequently been addressed by the Government. These include amendments to the obligations of licensees, changes to the circumstances in which ASIC must consult with APRA prior to revoking or varying conditions on a licence, and amendments to the *Australian Securities and Investments Commission Act* to mirror relevant changes in the *Trade Practices Act.*

The Labor members also acknowledge the submissions made by many organisations and individuals in support of an amendment to require the Product Disclosure Statement of any product with an investment component to disclose the extent (if any) to which ethical, social and environmental considerations are taken into account in the selection, retention and realisation of the investments.

The Labor members note the evidence from the Ethical Investment Association that the amendment would "facilitate good choice by consumers, by virtue of giving them information...[and] facilitate the growth of the social responsible investment industry."[5] However, the Labor members note that the framework in which this amendment has been proposed differs from the UK, where the words of the proposed amendment originate. The Labor members are concerned this would significantly undermine the effectiveness of the objectives of the proposed amendments.

The Labor members are also concerned that the words in the amendment may not be subject to an accurate definition, which will make the amendment difficult to comply with and provide comparable information for consumers. The Labor members were not convinced that "ethical" can just be defined as "anything that is not purely a financial consideration"[6], as suggested by Mr Kerr of the ACF. The Labor members also note the comments from Miss Ralph of IFSA that "Investment managers who necessarily do not adopt that style of investment strategy could comply with the law by making quite general statements about how they screen companies for the legal compliance or whatever."[7] In that case, mandating the disclosure of something which is currently voluntary and clearly distinguishes an ethical investment product from other investment products would confuse the consumer.

The Labor members see ethics, social well-being and the environment as vital issues for the corporate sector, consumers and the community generally, and see the need for a thorough and informed analysis in this area. The Labor members of the Committee are therefore still considering whether the proposed amendment will be the most

[5] Committee Hansard, pg. 244

[6] Committee Hansard, pg. 50

[7] Committee Hansard, pg. 122

effective way to encourage a worthwhile activity. We wish to examine whether the objectives of the ACF proposal can be met at a different time in a different bill to achieve a better result.

Superannuation

The Labor members of the Committee agree with the Chair that section 761G(6) has been inappropriately drafted. Section 761G(6) deems anybody dealing in a superannuation product or an RSA product to be retail client. It thus captures the situation where a trustee of a pooled superannuation trust issues an interest to a trustee of a superannuation fund that is otherwise a professional investor and deems such investor a retail client. It does not however, assist a retiree who receives a lump sum payment in excess of $500,000 and invests that in a non-superannuation product. The Labor members recommend that the section be amended appropriately.

The Labor members of the Committee have previously indicated that they understand that the Minister is to table a regulation exempting not-for profit superannuation funds from licensing so that, until super choice is introduced only public-offer funds will be subject to licensing under the Bill. The Labor members believe it is appropriate that, at this time, not-for profit superannuation not be required to be licensed.

The Labor members of the Committee also understand that even after that choice is introduced, the regime is to apply flexibly to superannuation trustees . The Labor members acknowledge that there are significant benefits for members of corporate and industry superannuation funds, as seen in the significant lower costs which members of corporate superannuation funds incur. The Labor members note that ASIC appears to have interpreted the requirements in the Bill to enable the existing system of representative superannuation to be accommodated within the regime.

The Labor members also note the undertaking by the Minister for Financial Services and Regulation in the second reading speech for the Bill that “[i]n relation to superannuation products that will be subject to the choice of fund regime, special transitional provisions will be prescribed in regulations once the timing of choice legislation is known.”

AUSTRALIAN DEMOCRATS SUPPLEMENTARY REPORT

Inquiry into the Financial Services Reform Bill 2001

Senator Andrew Murray - August 2001

Issues raised by authorised deposit taking institutions (ADIs)

I do not agree with the recommendation of the majority on this issue.

Under the Bill in its present form, basic deposit products that are for a term of 2 years or less and have no management or break fees still fall within the definition of 'financial product' but are not subject to all of the disclosure requirements.

The majority have recommended instead that the Bill should exempt from the definition of financial product all simple, well known basic deposit product and related non-cash payment systems. That would remove from the Bill all safeguards in relation to these products.

The Democrats are prepared to accept the concessions that the government have already made in the draft Financial Services Reform Bill on this issue and believe that the Bill in its current form is appropriate.

Disclosure of Ethical Investment Policies

As outlined in Chapter 5 of the majority report, the Australian Conservation Foundation, Ethical Investment Association and a number of other submitters advocated that the seller or issuer of a financial product disclose:

> The extent (if at all) to which environmental, social or ethical considerations are taken into account in the selection, retention and realisation of the investments.

Part 7.9 of the Bill could be amended to include this requirement.

KPMG/Resnik Communications in a survey last year showed that 69 per cent of Australians would consider socially responsible investing if given the opportunity. The Democrats are of the view that the investing public would welcome being given

the information necessary to allow them to know when an investment is environmentally, socially and/or ethically responsible.

The Democrats are not attempting to prescribe ethically or socially responsible investments, but we would like to encourage a marketplace, which is well informed about which funds include socially responsible considerations in investment decisions.

Ms Wade of the Ethical Investment Association gave evidence to the Committee that:

> We believe the amendment will do two things. First of all, it will facilitate good choice by consumers, by virtue of giving them information. Secondly, it will facilitate the growth of the social responsible investment industry.

Mr Erik Mather, Senior Manager, Institutional Business, Westpac Investment Management, was very supportive of a basic level of disclosure. In evidence, he commented:

> In terms of Westpac Investment Management, the support is for a basic level of disclosure. In fact, it would be in our best interests to oppose this disclosure, because we could try to carve out some sort of a commercial advantage, but in reality the long-term view is that people are wanting information in relation to this issue, and therefore we are supportive.

The argument against mandating this disclosure, contained in the majority report, is that market forces will deliver consumers the most transparent disclosure of socially responsible investments. The suggestion is that making the requirement mandatory is unnecessary. The Democrats would like to actively progress the advent of these types of products. It will be useful to start this process by asking in law that those who do take into account ethical, environmental or social considerations to state that unequivocally. In that way the interest in the availability of ethical investments will be heightened.

Any company making a claim that it considers environmental, social or ethical matters when making an investment should be required to substantiate that claim, which conveys a marketing value to the product.

ASIC should be tasked with providing a guidance note on what would constitute reasonable substantiation.

Recommendation:

That the Bill be amended to require that the seller or issuer of a financial product, with an investment component, disclose to a retail client at the point of sale, the extent (if at

all) to which environmental, social or ethical considerations are taken into account in the selection, retention and realisation of the investments.

Ownership of the ASX and clearing and settlement facilities of national significance

As outlined in Chapter 3 of the majority report, the current limit of a 5 per cent shareholding in the Australian Stock Exchange is to be replaced by a 15 per cent limit on ownership of financial market and clearing and settlement facilities that are prescribed as being of national significance.

Additionally, it will be possible for the Minister to approve a larger shareholding in relation to a market or facility where this is in the public interest.

I do not object to the maximum ownership limit on a financial market or clearing and settlement facilities being increased from 5 per cent to 15 per cent.

However, I do not agree that the Minister ought be given a discretion to approve a larger shareholding than 15 per cent.

I think that it is appropriate that if a person is seeking to take their shareholding beyond 15 per cent and the relevant Minister approves of that intention, it should be incumbent on the Minister to return to the Parliament with amending legislation.

Recommendation:

That the Minister's power to approve a shareholding larger than 15 per cent in a market or clearing and settlement facility be removed from the Bill.

Disclosure of Commission

I disagree with the majority report in respect of the disclosure of the quantum of commission on risk products.

It was suggested to the Committee that agents are not influenced by commissions paid, but are concerned with business considerations like competitive premiums and efficient claims departments. It was further suggested that the main customer issue is that commission is payable rather than the amount of the commission.

I can understand the argument for complete exclusion of risk-based products from the commission disclosure regime. If that is a view that is carried so be it. However partial disclosure seems inappropriate.

If it is accepted that the payment of a commission is significant to a customer then surely full disclosure of the quantum is also important. Presumably the quantum determines the degree to which any agent is likely to be influenced by the existence of the commission.

Given a choice between requiring disclosure and not, the Democrats will almost invariably err on the side of disclosing, unless that is likely to cause too great an administrative burden, or is unnecessary.

The vast majority of submitters who opposed disclosure of commission on risk products did so on the basis that the move would not benefit clients because that commission was not a factor in making their decision. There was no recurrent suggestion that disclosure would cause significant harm or inconvenience to any group.

Senator Andrew Murray