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SENATE

SELECT COMMITTEE ON SUPERANNUATION AND
FINANCIAL SERVICES

**Reference: Choice of Superannuation Funds (Consumer Protection)
Bill 1999**

THURSDAY, 18 NOVEMBER 1999

MELBOURNE

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SENATE
SELECT COMMITTEE ON SUPERANNUATION AND FINANCIAL SERVICES
Thursday, 18 November 1999

Members: Senator Watson (*Chair*), Senator Sherry (*Deputy Chair*), Senators Allison, Chapman, Conroy, Hogg and Lightfoot

Senators in attendance: Senators Allison, Sherry, Watson

Terms of reference for the inquiry:

Choice of Superannuation Funds (Consumer Protection) Bill 1999

WITNESSES

BUN, Ms Mara, Policy Manager, Australian Consumers Association	1
MIKULA, Mr Christian Valdemar, Solicitor, Consumer Protection Unit, Legal Aid Commission of New South Wales	1
SMITH, Ms June, Manager Legal and Compliance, Financial Planning Association of Australia	9

Committee met at 3.53 p.m.

BUN, Ms Mara, Policy Manager, Australian Consumers Association

MIKULA, Mr Christian Valdemar, Solicitor, Consumer Protection Unit, Legal Aid Commission of New South Wales

CHAIR—On 20 October, the Senate referred the Choice of Superannuation Funds (Consumer Protection) Bill 1999 to the committee. The committee is to present its report on this bill on 22 November. The committee has received seven written submissions about this legislation. These submissions have been examined by the committee and will be considered, along with the evidence received today, in preparing the committee's report.

All of the witnesses who appear before the committee are protected by parliamentary privilege with respect to the evidence given before the committee. This means that they are given broad protection from action arising from what they say and that the Senate has the power to protect them from any action which disadvantages them on account of the evidence given before the committee. The committee prefers to conduct its hearings in public. However, if there is any matter which you wish to discuss with the committee in private, the committee will consider your request.

I welcome Ms Bun and Mr Mikula to today's hearing. I invite you to make an opening statement and at the conclusion of that members of the committee will direct questions to you.

Ms Bun—This is a bill which has been about 10 years in coming. It initiated in the late 1980s, and I think we are all aware of the practices in relation to the selling of life insurance and superannuation products as well as the disclosure of commissions which has been a crucial point of contention.

CHAIR—And there was also an interim arrangement.

Ms Bun—There is always an interim arrangement. Indeed, that is the case. The crucial difference about where we are now in this debate is that we see a number of what we thought were old problems in selling coming back, and Christian will certainly comment on some of those. We see that choice in superannuation appears to have much greater momentum in the market than it has in the parliament. Indeed, I think it is quite clear, regardless of whether you think it is a good or bad thing, that consumers are confronting some very real market choices. The Commonwealth Bank's production of its super choice product, I think, casts a very different shadow on this market as it grows.

Without the benefit of education, the protection against misselling that comes with penalties, the clear disclosure protections that force commissions that may sway advisers in the wrong direction, we are very concerned, given the absence of CLERP 6 legislation that could offer those protections, that the kind of scenario whereby consumers simply make bad choices and then we have the enormous cost of having to rectify that because we have not fixed it upfront is very real.

CHAIR—So you would like this legislation to pass through fairly quickly, would you?

Ms Bun—We think this legislation needs to be seen as part of a package. It is a crucial part of a package which we support very much insofar as it deals with life insurance selling by agents and it relates to superannuation as opposed to other risk products. We definitely think that is an important section of the super market. It in no way represents the entire consumer protection environment in superannuation choice implied by its name. So we would agree with those who suggest that a more appropriate name is probably in order.

Nevertheless, it is pretty crucial. It is also important that things like the due diligence provisions, the warranties, the particular nature of the disclosures in the bill be tightened up before it is introduced. But if we improve it, rename it and get it on the marketplace quickly, we think that would be a very smart thing. Perhaps it also needs to be seen in conjunction with a kind of pre-emptive education process. Frankly, the market is going to educate in very biased ways. We think the government has a role very quickly in providing a more secure environment for consumers to make choices.

Mr Mikula—In the submission we have provided, we have detailed a few case studies. The most recent one concerned a return to the ‘good old days’ of misselling practices perpetrated on Aboriginal communities in the Northern Territory.

CHAIR—I would hope that you mean the ‘bad old days’.

Mr Mikula—For the agents it might have been the ‘good old days’. We see the bill as important in that respect in setting clear standards, in putting a positive onus on advisers to assess the financial position of those who are selling products because, in those sorts of communities, there is an almost complete reliance on the advisers, particularly if they have documentation which shows the Aboriginal logo.

In relation to choice in superannuation, a number of cases have come forward. I also have pulled out some of the decisions of the life insurance complaints service which I can hand up. They show the sorts of problems which arise and they show that consumers are confused by choice and will rely on agents, even where it is clearly not in their own financial interests. Those cases are coming through already.

Senator SHERRY—They have always been there.

Mr Mikula—They have always been there. The cases show marketplaces being approached—teachers, policemen, companies changing superannuation systems generally—that those sorts of things are happening, that people are getting access to workplaces and that misselling is going on. It is therefore, we say, disingenuous to say that there are not any problems out there. Show us the problems first. We say that for two reasons. First, even in this limited capacity, in which I am involved, we have been able to identify a number of instances. There are no specialist workers in this area and there are also time lags of two to four years before people realise that something has been missold to them, usually. The sorts of problems we are seeing now will come to light down the track. So the sooner these sorts of standards are in place—paper trails created which can be checked and the sorts of standard obligations that go with paper trails and increased accountability—the better.

CHAIR—Given the lower switching costs of getting out of one product into another, which this committee was instrumental in bringing about, the consequences probably are not quite the dire ones that were there in past years. People will be able to move with their feet or their hands or their super products if they perceive them as not being satisfactory.

Mr Mikula—It is correct that there are not quite those penalties, but there are still more difficult issues for consumers to grasp. There are still commissions being paid. While that used to be a clear indication of problems with high fees, there are now different issues about the level of return and whether you are better off. Government superannuation scheme members, in particular, can be targeted, I think.

Ms Bun—We are not arguing that there should be no contestability. We support choice in superannuation under the right circumstances. What we are saying is that, if you offer to consumers the prospect of investing \$1,000 in 30 or 40 different funds and explain what the outcome over 10 years in reality would have been, if they can see the difference they might understand that there is some kind of basis for comparison needed and it goes beyond the incentive that an adviser may have and not disclose. So your range of choices automatically could be limited without your understanding that the benefit primarily goes to the adviser as opposed to the investor.

CHAIR—You have indicated that you are not happy with the title. Do you have an alternative title you would like to suggest to the committee?

Ms Bun—We have an extremely boring alternative title. We have lived with the boring title of ‘Life Insurance (Conduct and Disclosure) Bill’ since 1988 when it was first discussed. Now that it has been limited in scope to deal with superannuation, as opposed to life insurance but for the life insurance sector, how about the title ‘Life Insurance Superannuation (Conduct and Disclosure) Bill’? That is, I am sure, not a very elegant proposal, but it is about selling through the life agency.

Senator SHERRY—I am not sure that is an appropriate proposal because doesn’t that give the impression that that is it, that that is the end of consumer protection in the event that we ever see the dreadful light of day for superannuation choice?

Ms Bun—Senator Sherry, our proposed title does not mention the words ‘consumer protection’.

Senator SHERRY—No, as I understand it, apart from the reference in the title, the word ‘superannuation’ is only mentioned once through the whole bill and that is in the definition of a group scheme. So it is clearly the bill that has been hanging around for 10 years which had to do with life insurance conduct and disclosure. Why should we have any part of a subterfuge in respect of the title which gives a misleading impression?

Ms Bun—My understanding of the bill is that it does not cover risk products such as life insurance and that those products will be discussed under CLERP 6 and are right now the matter for great debate within the finance sector. We think this is an excellent opportunity for parliament to get at this with support across all parties to indicate that these are

reasonable standards and, as move into a CLERP 6 environment, everything gets harmonised within that.

CHAIR—Would you please state that title again?

Ms Bun—It is such an embarrassing title and we probably should not dwell on it—the ‘Life Insurance Superannuation (Conduct and Disclosure) Bill’. It is about the conduct of selling superannuation by life insurance agents and the disclosure therein.

Senator SHERRY—I contest that. Frankly, I put it to you that the renaming of this is just a total subterfuge in respect of so-called superannuation choice, isn’t it? That is the intention of the government.

Ms Bun—We are less concerned with the intention of the government than we are with achieving these very important objectives for investors at this time when superannuation is becoming highly contestable in the marketplace.

Senator SHERRY—In some areas it is. I have evidence of that myself, which is why I intervened earlier. It is a total subterfuge to give the impression that this resolves issues for superannuation choice and consumer protection, because it does not.

Ms Bun—I would certainly put it to you that, in the kinds of cases that the Legal Aid Commission of New South Wales have put forward, this bill will clearly solve very important problems.

Senator SHERRY—Some.

Ms Bun—They are limited, I agree, and we need to move quickly beyond them. If I can also simply comment that, if this bill did not exist, we would continue to see more activity in the marketplace forcing consumers of many companies and government departments to make choices without these protections.

CHAIR—So you would be happy with your new title. Then if we change the title, would you welcome the speedy passage of this bill?

Ms Bun—This is a highly compromised bill. Of course we welcome its speedy introduction, but perhaps—

CHAIR—The name seems to be your only opposition to it though.

Ms Bun—Indeed, it is an important one. Christian may comment on some of the other core elements which we have mentioned over the 10 years, including the introduction of due diligence defences.

CHAIR—Today we want to concentrate on the issues in this bill.

Ms Bun—Those are the issues in those bill, yes.

CHAIR—For example, if you feel that the title may not be as descriptive or accurate as the contents of the bill imply, then you can put it to the committee. But that is not a big issue, is it?

Senator SHERRY—She has.

Ms Bun—Tick, that one is done. There are some more important issues.

Mr Mikula—There were some issues in terms of the detail of the bill. One more minor thing was that life insurance and superannuation products, by their very nature, are long term. For that reason, we say that the powers given to the courts under the bill are too limited. There needs to be a more generalised power to actually rewrite the contract. You might not want to have the policy cancelled and get a refund; you might want it to continue but with variations, for example, if these were misrepresented to you or something like that. The courts do need more flexible powers, which has been given in the trade practices area, as I think I have mentioned. But it is even more pressing in this situation where you have contracts that will go for 30 or 40 years; you need to have that flexibility.

Senator SHERRY—Could you provide us with some detail?

Ms Bun—The details are in the submission.

Mr Mikula—In the submission I have referred to the model in section 87(2).

Senator SHERRY—Have I got the whole submission? Mine is eight pages.

Mr Mikula—There are two submissions.

Ms Bun—Christian, I think you are talking about the legal aid submission. Senator Sherry, are you looking at the ACA submission?

Senator SHERRY—Yes.

Ms Bun—Do the committee members have the Legal Aid Commission's submission?

Senator SHERRY—No.

Ms Bun—If that could be copied because that is a terrible shame. I do not know how that happened. There are very specific remedies and suggestions to you in that submission.

Mr Mikula—I am glad we clarified that.

Senator SHERRY—I am glad I did, because I was getting a bit concerned about where these specific changes were, other than the very minor fracas about the title.

Mr Mikula—I will move on from that, because I think that is a minor point and the submission does refer to the section of the Trade Practices Act. I come to the defence of due diligence—I have been involved in the bill for some time—which initially extended only to

directors and it has now been extended to companies. Leaving aside the philosophical reasons for it, as a lawyer, I would think it has the potential to add considerable complexity to any sort of legal proceedings because, in order to invoke the defence, the directors will have to come before the court with their systems. They will have to open up the company and show what levels of review they had in relation to documentation. The level of discovery of documents can be quite intense. It might extend to the CEO's diary and notes like that to show how many meetings they had attended and what their availability was when they said that they were too busy with other things.

It is false comfort for the life insurance industry to have that defence because, at the end of the day, if pressed and asked to produce evidence of their systems, they will generally be reluctant to produce it before the courts. In any event, it does not necessarily resolve things. If you have shifted the blame to a third party, someone who has prepared these documents, then you potentially have an action against them in negligence presumably and they would be joined to the proceedings.

So, from the consumer's point of view, it has the potential to add significantly to the costs with very little practical benefit. We would say that those matters are better resolved by means of indemnity agreements between the life insurance companies and those whom they outsource particular tasks to so that they can distribute the loss between themselves rather than dragging the consumer into those sorts of battles.

In relation to disclosure of commissions, we have some difficulty with the model that is proposed. We do not think that it will be complied with properly. The reason we say that is there are similar disclosure requirements under the Insurance Contracts Act on suppliers of goods and services such that, when they sell insurance, they are meant to give notice in similar terms. Over the last eight years that I have been working in the area, I have asked a number of people for copies of those sorts of notices. They are only ever provided in relation to consumer credit insurance, the reason being there is a specific statutory regime there. So we have concerns about the level of compliance with it.

In relation to the model that is set up, we also have concerns that what will happen is that it does not necessarily empower consumers. The model that has been set up envisages that the adviser or broker will have selected a product and you can then ask about the commission on that product. It might be that, in fact, there is a range of products appropriate to your needs but the adviser has chosen the one with the highest commission. So what you are not being told is what are the products that are available and what the commission is, and all those sorts of things. If the adviser says that there are four products, and I have selected the one that pays me a 40 per cent commission instead of a five per cent commission, you are not being given that comparison information. While we could live with it in its current form, we think that, down the track when it comes into effect, the timing of that sort of disclosure might be something that needs to be looked at.

Senator SHERRY—On that last point, you mentioned about down the track and the timing. I am sorry, but we have not had a chance to look at the document. Have you suggested a way of resolving that problem in your document vis-a-vis an amendment to the bill?

Mr Mikula—No, but I would be happy to turn my mind to it.

Senator SHERRY—I think that would be useful. It seems to me that, in this area, ‘down the track’ has been 10 years so far.

Mr Mikula—Yes.

Senator SHERRY—If we have the opportunity—with our party and whatever agreement is reached in the Senate—to fix this problem, I think we should try to deal with it while we have the opportunity.

Ms Bun—I think it is a crucial one. It is terribly naive to imagine that advisers have to offer every product on the market to everyone. Obviously that is not going to happen. But somewhere between that and a sort of point of sale—here is what I chose—is probably a good compromise.

Senator ALLISON—I have one question. It concerns part of the submission by IFSA where it suggests that ‘the introduction of a special regime for life insurance products will introduce inconsistencies into the law and impose significant compliance costs on industry, particularly at a time when it is gearing up for CLERP 6.’ Can you give us an argument about that?

Ms Bun—I think that is a very reasonable concern on their part and, realistically, we would like the entire industry to be covered at this time. It is only because we have the difficulty of having extended CLERP 6 for various reasons and at the same time recognising that we have real activity in the marketplace at present that we think the compromise is realistic. We would also hope that, if we are able to achieve a set of robust protections in this bill, this could be the very platform for CLERP 6. This would mean that, as the industry harmonises, they will not incur extra costs; they will just have a learning experience getting there.

CHAIR—Perhaps it could be said that this bill is an acknowledgment of the lobbying power of the consumers coming in at this stage.

Ms Bun—I hope we can continue to say that over coming weeks.

Senator SHERRY—I am sorry to say that that was not just in response to you but I suspect it has a more subtle agenda attached to it.

Senator ALLISON—There is another issue in IFSA’s submission about the regulation making power under part 5 of the bill. IFSA say that, in their view, ‘This proposal exceeds the original consumer protection provisions that saw the code as commissioner’s rules issued by the Insurance and Superannuation Commissioner and is far more prescriptive in nature than is the intent of CLERP 6.’ Their members question why a more rigid paperwork is now seen as being more appropriate. Can you comment on that?

Ms Bun—I would start by suggesting that not all IFSA members have that view. Some very big ones are very supportive of this bill and, in fact, already have this kind of

disclosure in place as market conduct within those particular companies. Secondly, the intention of CLERP 6 is very easily described as being something that is almost light touch compared with the products, reasonable levels of information and so forth. However, once we get into the meat and guts of it, we will have to talk about comparative disclosure, key features, environments and commissions—all of those things. It is easy to toss this as being on the tough end of the pointy black-letter stick, but I really think this is about preventing a set of market conduct problems which have been around and have been recurring for more than a decade now. The question is: how can we deal with them without a reasonably clear and comprehensive framework?

CHAIR—We apologise that we are running late. Thank you both for appearing.

[4.20 p.m.]

SMITH, Ms June, Manager Legal and Compliance, Financial Planning Association of Australia

CHAIR—Thank you, Ms Smith, for appearing.

Ms Smith—You have a copy of the submission made by the FPA. I will just expand on some of the points made. Firstly, the FPA fully supports the introduction of appropriate legislation for consumer protection and has vigorously campaigned for uniform and consistent reforms. In looking at this bill, it has isolated three weaknesses which are underpinned by its stance on uniformity and consistency. I will just address those very briefly.

The first, in effect, goes to the fact that the bill has no power for ASIC to be able to investigate, hold hearings and ban life insurance advisers for serious misconduct, similar to the powers it has under the Corporations Law. The issue of the FPA is one of individual accountability as a deterrent to misconduct or incompetent practice. The FPA agrees with the powers in the bill for the civil and criminal responsibility for the broker and life institution. However, its view is that there should be an additional power inserted in the bill similar to sections 829 to 840 of the Corporations Law in relation to the securities industry. Those sections, as you know, have been successfully used by ASIC to take action both at a corporate and individual level.

Whilst the power to hold the life institution and a broker accountable is obviously necessary, problems can arise when agents act inappropriately or unprofessionally. Agents are free to move around the industry, being recycled effectively from one provider to another because defamation laws restrict the flow of information between companies about alleged misconduct. Whilst a life institution may account ultimately for any losses caused by such an agent, damage is done to the reputation of the industry as an honest and reliable source of advice.

From a policy perspective and a consumer protection standpoint, individual accountability should be addressed as it is for the securities industry in the present Corporations Law. There needs to be professional accountability, the FPA believes, at the individual level as a deterrent to misconduct or incompetent practice. The weakness can be overcome in the FPA's view by giving ASIC powers similar to those found in division 5 of the Corporations Law, excluding persons from the securities industry.

In relation to the second point made in the submission, the issue is in relation to no prohibition on the giving of advice of super and life products by unlicensed persons. The salient issue relates to the control mechanism which is presently linked to the transaction itself. The FPA would say that the control mechanisms should be in and around the giving of the advice and not the transaction.

For example, section 31 of the bill is the offence provision making it an offence for a life company to issue or vary a policy where the client has received advice from a life insurance agent and certain things are not done—for example, the disclosure of commissions.

Then the offence gives rise to a civil action to compensate the consumer. The definitions relevant to that offence provision are found in section 27 of the bill. It defines a life insurance agent as an agent or subagent of a life company, a life broker, an employee of a life company or anyone else authorised to give life insurance advice.

This definition may allow for an accountant, for example, to charge a fee for advising a client on a particular product provided that they did not attempt to implement the transaction. The weakness, as the FPA sees it, is that there is no accountability under the bill for this type of advice, no assurance the adviser meets minimum competencies and no complaint resolution scheme available in relation to the advice. It is ostensibly advice that will be unregulated. The FPA believes this is a weakness which can be easily overcome by the protection being centred on the giving of the advice itself and not just that which is controlled through the acceptance of a policy transaction by a life company.

Under section 780 and 781 of the Corporations Law, there is a prohibition on the giving of advice on securities unless you are a licensed or proper authority holder. The FPA would argue that there should be a similar clause in this bill—that is, a prohibition on advising on life and superannuation products without being a recognised life insurance adviser, broker or life company as defined under the bill. This we see as an issue of consistency for the licensing scheme and also in preparation for CLERP 6. In effect, the FPA would argue that the advice should only be relied upon if the adviser is competent and accountable, and the way to ensure that is to regulate the adviser not the transaction.

Lastly, the submission makes reference to another weakness in the FPA's view in relation to disclosure, and that relates to the proposed exemption for disclosure of commissions for risk insurance policies, which is presently found in clause 29(7) of the bill. The FPA's view is that there should be full disclosure of all commissions—that is, a general policy stance which it adopts across the board.

The FPA does not subscribe to the view that, given commissions are paid by a company and do not affect the price, a consumer is not disadvantaged, nor that a consumer is concerned with commissions paid but merely the quality of product and cover. The FPA disagrees that there is a sale hurdle with disclosure of commissions and there is certainly no industry evidence to that effect.

Whilst there is a move towards the concept of a flatter level of commissions, it is not the only type of commission paid. As is known, variation in commissions can be great—up to 120 per cent of the first year premium back to a flat 15 to 20 per cent of the initial premiums paid.

In addition to this, there is the issue of volume commissions and bonuses to be taken into account. The FPA would argue an adviser might lean towards a particular product because of the commission payable—that is, a commission may influence the making of a recommendation and lessen the accountability of the adviser to demonstrate to their client that their duty to act in the client's interests has not been compromised by the receipt of a higher commission rate or a volume bonus.

Disclosure of all commissions is consistent with the policy directions of CLERP and industry regulation for financial services in general. It does appear inconsistent with these initiatives to have such an exemption in this bill. In effect, it is the FPA's view that the client should be the judge of whether or not a conflict of interest has arisen for the adviser in making recommendations about the particular product to be sold. The FPA would argue that that particular weakness can be overcome by simply removing the exemption from the bill.

CHAIR—That is very comprehensive. It is interesting to see some of the items in that submission. As you know, this is just—not a temporary—a transitional one pending CLERP 6.

Ms Smith—Yes.

CHAIR—Thank you very much for what you have put forward. There is an argument about risk products versus other life products. I was interested in the way your argument included risk products, because there is quite a lot of controversy within the industry as to whether they should be in or out. I think that is one of the reasons why it may have been deferred to CLERP 6.

Ms Smith—Yes. The FPA's stance is a general one: that all commissions and fees should be disclosed and that that should be consistent and uniform.

CHAIR—Long term there is no doubt that that will be the outcome.

Senator ALLISON—I do not have any questions, thank you.

CHAIR—Do you have worries about the name?

Ms Smith—No. I will leave that to my predecessor.

CHAIR—Thank you very much for appearing before the committee and for your time and the manner in which you presented your evidence. That concludes the hearing of oral evidence.

The committee will be proceeding to prepare a report for presentation to the parliament on Monday 22 November on this particular bill. We will ask the minister his position in relation to certain titles and a number of other issues on this legislation. We do not have the minister here with us to respond to the matters that you raised, Ms Smith, which is somewhat unfortunate. But we will certainly speak to the minister. I think their attendance is importance to any outcome arising from these hearings and we apologise for their absence.

Ms Smith—Thank you.

Committee adjourned at 4.30 p.m.

