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SELECT COMMITTEE ON SUPERANNUATION AND
FINANCIAL SERVICES

**Reference: Prudential supervision, global financial services and superannuation
guarantee charge**

MONDAY, 16 OCTOBER 2000

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SENATE
SELECT COMMITTEE ON SUPERANNUATION AND FINANCIAL SERVICES

Monday, 16 October 2000

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

Senators in attendance: Senators Allison, Conroy, Hogg and Watson

Terms of reference for the inquiry:

For inquiry into and report on:

- (a) prudential supervision and consumer protection for superannuation, banking and financial services;
- (b) the opportunities and constraints for Australia to become a centre for the provision of global financial services; and
- (c) enforcement of the Superannuation Guarantee Charge.

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Committee met at 11.24 a.m.

CHAIR—I declare open this public hearing of the Senate Select Committee on Superannuation and Financial Services. This is the eighth public hearing into the committee's main terms of reference. The aim of today's hearing is to take further evidence on two of the committee's terms of reference; namely, (a) the prudential supervision and consumer protection of superannuation, banking and financial services and (c), the enforcement of the superannuation guarantee charge.

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 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 hearing in public, however, if there are any matters which you wish to discuss with the committee in private, the committee will consider your request.

[11.25 p.m.]

TENNANT, Mr David, Director, Care Incorporated, Financial Counselling and Consumer Credit Legal Service

CHAIR—Welcome. I invite you to make a brief opening statement.

Mr Tennant—Thank you. Our written submission dealt mostly with the term of reference (a) and was relatively short. It reflects our practice experience, and I thought it may be useful in my opening address to draw attention to some of the common themes which appear to come out of our service delivery experience and other consumer policy comment which has already been made to the committee. Some of those points are as follows.

Firstly, on the limited consumer resources, I believe that most of the consumer comment that has been made to the committee has drawn attention to the grave difficulty that the consumer movement, in general, has in providing comment to inquiries of this type. At the moment, we have no functional peak bodies, in the sense that they had resources which would enable them to research and provide fully informed comment to committees such as this. I believe the committee has already heard from Chris Connolly, who is the chair of the Consumers Federation of Australia. I am the deputy chair of the Consumers Federation of Australia—which basically means that Chris and I share lamenting phone calls about how little it is that we can actually gather from our colleagues in other states about what is happening at both service delivery and policy development levels in the consumer movement.

I should also point out to the committee that, since Care's submission was presented in January of this year, we have actually been unsuccessful in obtaining funding to continue our consumer credit legal service, and that service was unfortunately closed on 30 June 2000. It is not simply in the area of policy development but also in direct service delivery that the consumer movement finds itself going backwards. Our experience in that respect is that the most vulnerable consumers have real problems in accessing protection mechanisms, and although there might be some very good mechanisms of that type available in legislation, it is not much use if consumers cannot get access to those mechanisms.

Secondly, and perhaps leading on from that, is the apparent diminution of consumer affairs as a Commonwealth priority. I do not believe there is anything useful that I can add to the comments already made by the Financial Services Consumer Policy Centre on that score, except to say that we endorse those comments and share that concern.

In relation to the cost of banking services for low income consumers, Care's experience is certainly at the coalface. We believe that far too little has been done by any of the major banks to ensure that there are appropriate low cost banking products for low income consumers. I cannot think of a way that this can occur without there being some sort of legislative intervention. I would also like to draw the committee's attention to the apparent confusion between what has been described as loyalty schemes with short-term profitability. For example, older consumers who might have banked in the same place for a lifetime, purchased a home through a particular institution and so on, are no longer apparently wanted as customers when they are no longer profitable to the institution. So the accounts that they may require in later life, which suit those on a low or fixed income, simply are not available to them; and while they

are no longer paying interest rates on home loans and the like they are no longer of interest to the institution.

I would also like to note the problems that we experience on a daily basis in helping our clients in getting appropriate responses from institutions to reports of financial difficulty. Although it is not entirely within the committee's purview, there are mechanisms available in legislation like the consumer credit code for dealing with financial difficulty; but again, notwithstanding those protections, it is very difficult for the ordinary consumer to get that sort of protection or to get access to the protections in the legislation.

In relation to superannuation choice, we have not dealt with that matter in our submission. It is not an area in which we would claim any particular expertise, but I would like to endorse comments I understand that Mr John Berrill made to the committee in May of this year, that low income consumers have very little understanding of superannuation in general nor any particular interest in learning more about superannuation products. It simply does not figure in the types of issues that they are dealing with on a daily basis. The only caveat I would perhaps put to that is that our clients do develop an interest in superannuation to the extent that they might need early access to those funds to cope with financial hardship. Our experience in that respect is that it is very difficult for the average consumer to navigate those processes or to have any successful outcome to a request of that type.

On the question of regulatory oversight, in our submission we have drawn attention to the sometimes confusing processes that are currently available and the difficulty that we experience in obtaining appropriate feedback for our clients. I have provided a case study example of a particular referral that Care had made to ASIC and the ACCC. Mr Connolly of the Financial Services Consumer Policy Centre drew attention to problems in obtaining acknowledgment on broader issues. We share concerns in relation to issues like bank mergers. Our casework experience suggests that merger activity decreases customer service, especially in the area of complaints handling.

CHAIR—Banks have been known to keep changing the menu that they offer—a product that was once charge-free suddenly becomes subject to charges, but they do have other ones that are available on request. To what extent do you advise people to shop around or get the latest account range within banks? Do you encourage them to go outside that particular bank to other banks, credit unions or other institutions to see what they have to offer?

Mr Tennant—Absolutely. It is not just a matter of consumer sovereignty in the sense that people can shop around for the most appropriate products. It is often a matter of absolute necessity that people try and find products that suit their means. You have suggested that products of that type are available on request. Our casework experience suggests that 'on request' actually means something more than a simple request. Often times it means badgering institutions to find information about products of that type. Because they are not products that would be described as profitable to institutions, the information available about them is often harder to get. Front-line staff, who take more the form of marketeers these days, seem to have ample information about upping limits on credit cards but very little information about basic banking products. For the low income consumer who probably has a number of other very difficult problems to juggle in their life, attaining that sort of information freely and easily is a matter of great difficulty.

CHAIR—But it can be done. With your assistance you would be able to direct them to the right sort of account?

Mr Tennant—To the extent that an agency like ours has the resources to be able to respond to questions of that type and steer people through the process, my answer would be yes. But the difficulty that we face is that we are an agency primarily that responds to financial crisis in people's lives. We endeavour, within our limited resources, to juggle in a way that meets people's needs for information but also deals with and responds to the crisis that they are facing at any particular point in their life. Those services do not take people by the hand and lead them through it. They attempt to give useful pointers and then, unfortunately, in a lot of cases we send people straight back out to information lines. Our experience suggests that they do not easily access the information they need through processes of that type.

CHAIR—I was reading where a person of reasonably modest means had \$10,000 to \$20,000 to invest and that was the sole investment. They were put into a master trust arrangement with fairly high entry fees and continuing fees when really they would have been better investing in a bank product associated with a wholly owned hire purchase arm where they could have got a reasonably high rate of interest. If you had \$100,000, \$200,000 or \$300,000 in the trust, you could do reasonably well with low amounts. Do you have many complaints of that order—of people who have been put into inappropriate investments relative to the scale of their overall operations?

Mr Tennant—We would receive complaints of that type rarely, if at all.

CHAIR—Really?

Mr Tennant—Yes. Our casework experience suggests that our clients are flat out having \$100 in their account, let alone having many thousands of dollars for investment purposes. To the extent that we do have people who have investment issues, it is more of the nature of older or retired persons who have their main investment in their home. In that sense, they are asset rich but cash poor. So the types of options that are available to them are limited because of their limited income.

CHAIR—Who are your clients? Are they people who run into trouble and have their power cut off and that sort of thing?

Mr Tennant—Yes. Indeed, one of our financial counsellors sits on the Essential Services Review Committee in the ACT, specifically because that is the client group that we target our services to.

CHAIR—So you do very little by way of responding to investment decisions which have gone wrong?

Mr Tennant—To the extent that we have any questions of that type, it would be for perhaps small business clients who may have entered a small business venture ill-advisedly and are then picking up the financial pieces. But it is more about dealing with financial difficulty rather than how they might choose to invest their money. In fact, with the commercial law reform package,

that is not a matter that a financial counselling agency would be able to look at in any event. We would not be likely to be licensed through a process of that type.

CHAIR—I will hand over to Senator Allison, who has a particular focus on consumer issues on this committee.

Senator ALLISON—Thank you. Mr Tennant, I wonder whether you have a view as to the regulatory approach that should be taken to overcome what you describe as a gap in the services available to people on low incomes and those who are better off. How should the banks be obliged to value the loyalty of many years of customer attachment?

Mr Tennant—It is my understanding that some other organisations have drawn the committee's attention to schemes that exist overseas. I do not pretend to be an expert on those types of processes but my understanding is that in Canada and the United States there are already well-developed ways of obliging large institutions to take account of social issues and to provide appropriate mechanisms for low-income people to have access to low-cost banking products. It is my view that, unless those types of things are made a precondition of licensing or there is an obligation to report against a set of social criteria annually, there will be no effective way of making sure that low-income consumers are protected and properly provided with a range of choices.

Senator ALLISON—You are in the business of educating people as well as giving them giving them advice, presumably; do you have a view as to how we can get a better-educated community of consumers? Should we start in schools? Is primary school too soon? How do we actually get information to people on a current basis?

Mr Tennant—We are extremely encouraged by some of the efforts that the ASIC Office of Consumer Protection are taking at the moment in this regard. There is a discussion paper on educating consumers of financial services products. It is exciting to us that that opens the possibility of partnerships with community based organisations to not only deliver education services that suit low income consumers but actually try and get some dialogue going with low income consumers about what they need and the manner in which that information would be most useful.

My real concern is, however, that no amount of education is going to assist people if the basic fundamental consumer protection mechanisms are not available for them to access in the event that they have a problem. In the ACT, we have seen the most critical example of that in recent times with the closure of Care's consumer credit legal service. The territory now has no dedicated consumer credit legal service. In fact, to the extent that cases of that type are being picked up, they have been subsumed within the ACT Legal Aid Office. Although it is not within the committee's brief, I am sure the committee would be aware of the difficulties that Legal Aid faces in providing the core services within their already reduced resources. Adding extra things that they need to consider to that list is unlikely to give Legal Aid many options on how they stretch their already limited resources. Unless consumers have the ability to question and follow through on issues of complaint, all the education in the world will not assist.

Senator ALLISON—In your experience, if organisations such as yours do not offer that assistance, where do people go? What is their first port of call? Do they ring the ombudsman, and do the mechanisms there allow them to progress the system? If not, why not?

Mr Tennant—They certainly call agencies such as the ombudsman and they would call other community based agencies to pick up snippets of information on the way through. The data that we collect from our clients suggests that they are not exclusively our clients: they tend to be clients of a number of different agencies at different times. They tend to make a number of different approaches to places such as the banking industry ombudsman, which would be relevant to term of reference paragraph (a). Our concern is that many people appear to receive initial rejections. For example, after they make the banking ombudsman their first port of call, they receive what they perceive to be a rejection. Yet when they obtain information about the way that they should perhaps have presented their complaint or the issues that would be relevant to the terms of reference, those things can often progress with the assistance of an advocate—whereas, without an advocate, they would not.

Senator ALLISON—That suggests that the banking ombudsman is not communicating adequately with complainants about the form of their complaint or the mechanism being used. Is that your suggestion?

Mr Tennant—No, I am suggesting that the banking ombudsman is a scheme based in Melbourne to cover all banks Australia wide. They receive an extraordinary level of contact with consumers from many different levels of society—not just low-income people. In trying to respond to that level of concern, some matters—unless they are communicated properly in the first instance—may not get the recognition they deserve. That is to say not that the banking ombudsman is not considering those matters correctly under the terms of reference, but that the information presented to the ombudsman is not presented in a way that allows that consideration to be made. It is my experience that that can be done only when there is advocacy assistance to help people who are not good at communicating those sorts of difficulties put before the ombudsman exactly what they want considered. Some of those things can be highly technical arguments or issues under the banking code of practice and most low-income people would never come into contact with those sorts of rules.

Senator ALLISON—But should the banking ombudsman not be accessible to all, regardless of education or insight into those legal issues?

Mr Tennant—To me, that is a philosophical divide between what is an independent alternate dispute resolution process and taking on the role of advocacy. There must be a line in the sand between those two roles. To maintain a credible level of independence, the banking ombudsman cannot be seen to be advocating on behalf of one party over another in a dispute. The role of an advocate is to present the person's complaint or situation in a way that would allow that alternate dispute resolution scheme to consider the issues. It is not the role of the scheme to investigate with the person or to prepare their complaint for them.

Senator ALLISON—I refer you to the recent trend towards call centres and distancing customers from banking operations so that you can no longer ring your local branch. Is that issue raised with your organisation?

Mr Tennant—Absolutely. It is not just a source of frustration for our clients; it is also a source of frustration for the people who advocate on behalf of those clients. It is extraordinarily difficult to navigate some of those processes. I guess Canberra is not dissimilar in a lot of ways to some regional centres, where the closure of local branches or the mergers of large institutions often means that management is transferred to Sydney or Melbourne and often collection departments will be centralised in another state altogether. Trying to get proper communication between different areas within an institution is as difficult as making contact with the institution itself. That was one of the issues that we drew attention to in the case study provided to the committee, where we were dealing with the one institution but in three other jurisdictions and the ACT and it was impossible for us to get a straight answer from the institution. We found it extraordinarily difficult to get any feedback from the regulators on what was happening, either.

Senator ALLISON—How do we solve that problem?

Mr Tennant—There should be some sort of regulatory responsibility to maintain a central point of contact for complaints mechanisms, a single point of contact internally in institutions—it seems like such a simple concept—and it should be described in a similar way across institutions. It is a matter that I believe should be considered in the review of the codes of conduct which is going on at present. It is certainly something that we have drawn attention to in our responses to the review of the banking code and the credit union code.

Senator ALLISON—Many witnesses have drawn attention to confusion between the responsibilities of ASIC and the ACCC and APRA. Do you have a view as to how we could cut out some of that confusion? Do you see the roles as being problematic? Are there big grey areas from your point of view? How could we sort that?

Mr Tennant—It is my understanding that some of those confusions may be alleviated to an extent with the commercial law reform package. In particular, the potential transfer of credit to ASIC will make an enormous difference to the way that our agency might raise complaints—rather than trying to work out which regulator we should take the matter to and how it should then be followed through. My grave concern is that, without a commensurate increase in resources to the regulators to properly follow through on those referral issues, we will see no improvement in the way that matters are being dealt with at present. We drew attention in the case study material supplied to what we described as a ‘lateral’ way of resolving a referral of that type—where ASIC and the ACCC wrote a joint letter to a particular institution. We think not only ought that type of activity to be encouraged but there ought to be some protocols between regulators to make sure that areas of common interests are communicated between them.

But, to the extent that consumer agencies should expect responses from regulators to referrals of that type, we simply do not get them. The clients who make referrals directly report not just similar experiences but grave difficulties even getting through the first level of speaking to an information officer on the telephone and having their complaint taken seriously.

Senator CONROY—You mentioned you thought it would be better if credit was consolidated—that that might make life easier. Have ASIC prosecuted any financial consumer issues in a court, that you are aware of, since that was transferred to them?

Mr Tennant—I am not aware of any. I would be happy to take the question on notice, but it is certainly not something I am aware of.

Senator CONROY—Would it possibly be a suggestion for financial service consumer protection in actual fact to go back to the ACCC, rather than having credit come across—having to reverse the case? I am agreeing with you on the consolidation issues. I am not sure that ASIC have got the resources now to follow through. And having credit given to them as well, while having their budget cut, does not leave me inspired with confidence. That is not a reflection on ASIC. Allan Fels and the ACCC have recently been given lots of extra money to prosecute a variety of issues. From a personal perspective, I would be happy to see it actually going in the other direction rather than having credit coming across, given that they have not, as far as I know, won one case in court yet or even necessarily tried to prosecute one case in court.

Mr Tennant—I am not quite sure I understand what the question is but if my response does not deal with it, perhaps you could—

Senator CONROY—Given that ASIC have been at this stage unsuccessful at prosecuting anybody, would it be better for the ASIC functions to go back to the ACCC rather than the other way? You were saying that hopefully that consolidation of credit across would make your life easier. I am saying that possibly the reverse might be a way to make your life even easier.

Mr Tennant—I do not necessarily believe that prosecution is the only way that you deliver consumer protection—although, if I could take the example of how harassment in the collection of debts has been dealt with by the ACCC recently, we were extremely encouraged by the work that the commission did in gathering consumer comment to prepare their section 60 guideline and were, in turn, extremely encouraged that the first case of that type ran recently in the Federal Court in Western Australia. That is where concepts of protection actually hit the cutting edge, if you like, and consumers see real benefit from effort of that type. My concern would be that, if you were transferring responsibility of that type to an entirely new area, you have to then build that expertise from the ground up. My understanding of ASIC's Office of Consumer Protection is that it is an extremely small and developing outfit at the moment and, without the proper resources to allow them to do that investigation at a ground level, it would be an excruciating process to see that develop something of the type of the section 60 guideline and successful prosecution.

Senator CONROY—Given that ASIC's funding was cut in the last budget, you cannot be happy at the progress. As you say they are building from the ground up. They are good people. They have appeared regularly before us. My observation is that they are continually underfunded. Would you agree with that?

Mr Tennant—Our observation would be no different. We are, as I said earlier, encouraged by endeavours like the consumer education endeavour. But, at the end of the day, education is not worth much unless you can actually deliver protection.

Senator CONROY—I now want to turn to your case study. I think you were trying to be very discreet in your study, so it did not really leave me any the wiser as to what had actually been going on. I was wondering if you could detail the practices that you are referring to in your study.

Mr Tennant—The types of issues came from a variety of different products, so I will not go into the minutiae of what those products were. Consumers reported problems with communications with their bank—for example, raising issues of complaint or concern, a similar degree of difficulty in finding an appropriate officer within the bank to deal with those complaints and similar descriptions of how apparent resolutions—eventually reached after some badgering to track down the person who would speak to them on the issue—were not documented. The consumers acted in reliance on those agreements and some months later discovered that those agreements had in fact not been communicated to other sections of the bank and that there was no internal documentation of any description about them. In some instances, those people were then subject to legal proceedings by the bank for recovery of moneys that, had the agreements as they were originally negotiated been allowed to stand, would not have been available.

We also attempted to navigate those complaints processes and, in a number of those matters, were able to negotiate fresh positions with the bank. In some instances, those agreements were the same agreements as the consumers reported having reached in the first place only to find that they were later breached again by the bank. That suggested to us a systemic problem. We attempted to raise that issue with the bank both at managing director level and even in writing to the chairman of the board of the bank. We received in response to those requests a copy of the bank's internal complaints handling process, which was the very same process we were drawing attention to having failed. Our frustration in that process was the reason we referred it to the regulators. I must say that my experience since then is that not much has changed. In fact, since Care's consumer credit legal service was facing closure, I received a similar complaint, and I was only able to provide the referring person with details of the complaints people at the ACCC.

Senator CONROY—Here is your chance to strike a blow. Are you under any confidentiality restrictions in terms of the agreements that were struck with the institution?

Mr Tennant—The agreements, yes, in some instances.

Senator CONROY—Oh, okay. The settlements? Or are you are not allowed to talk about that: 'They did X'? You still have not been able to enlighten me at this stage as to one of the examples of what they did. I do not want to put you in a difficult legal position—because obviously your first priority is to protect the consumer—but are there any instances you can describe to us of what they actually did? What transactions are we talking about? How did it happen within the confines of your legal position?

Mr Tennant—There is one matter that I had previously received permission from a client to discuss—and I see no reason why the same would not apply now—where the consumer was about to undergo some surgery, had a loan product with the bank, contacted the bank to inform them of the surgery—

Senator CONROY—What was the type of loan product? Are you able to identify the loan product?

Mr Tennant—It was a loan product with a continuing credit facility, but not a substantial one, not a revolving home loan—a product that would have a limit on it and a card attached to it

so that you could reuse credit up to an agreed limit from time to time, but not a straight credit card. The consumer, in making the report of the hardship, asked for a period of some months to allow recuperation and to commence payments at a reduced rate initially and then to make up missed payments over a period of time. Having thought that agreement was reached, the consumer went off to hospital and had the operation—only to find, after the payments had commenced, collection calls started asking for an immediate repayment of arrears. It was not possible for the consumer to negotiate on the basis of the original agreement. The bank, in fact, commenced proceedings against the consumer. Our intervention was able to stop those proceedings and to enforce the original agreement, but without admission that the original agreement had existed in the first place.

Senator CONROY—Which institution?

Mr Tennant—St George. That is why Care has a particular concern about merger activity: our experience in the ACT community is that, where there has been a merger of large institutions that had a particular presence in the ACT, Canberrans have been poorly served by merger activity of that type and poorly served in the mechanisms by which they might wish to draw attention to problems with their personal accounts.

Senator HOGG—I just want to pursue one issue, and that is the issue of education of consumers, that you raised earlier. We have had evidence before this committee that something like 15 per cent of people are functionally illiterate out there, and I think the percentage goes as high as about 45 or 46 per cent of people who have very low literacy skills anyway. How does one protect these people, given the sort of evidence you have given to us this morning? Education becomes difficult because, no matter what one prepares—and that is invariably in a written form—they are not able to absorb it. That is not being elitist in any way; they just functionally cannot cope with that sort of information. How does one protect these people and stop them from turning up on your doorstep to be your clients? Is it a matter that, as more and more sophisticated technology comes on stream, these people are going to also be even more disadvantaged? Would you like to address that as well?

Mr Tennant—Our sense of that is that there will be a very definite understream of people who only have access to particular types of products, presented in particular ways, because of their incapacity to either access or understand more complex products. There may be good financial reasons for that, because those more complex products are not suited to their circumstances. But there might also be some grave disadvantage in having low income, fixed income consumers only able to access the market at a particular level.

In response to the comments about the problems where most of this information is document based, I agree with that point except that there was some research, in the review of the uniform consumer credit code, conducted by Justin Malbon of the University of Queensland. It shows some surprising results about how consumers felt about the documents they were given with their credit contracts. Although many consumers admitted to not having read those documents in detail, or even understood much of the information, they felt a considerable level of confidence that having that information was useful to them so that if there ever was a problem they could seek advice from somebody, knowing that they had those contractual documents to take with them. It also encourages people to ask more questions at the point of sale if they are required to be provided with certain documentary information before they can enter the

agreement. Although the assistance they might get is limited at that point, it does prompt some inquiries that otherwise might not occur.

Senator HOGG—Thank you.

CHAIR—Thank you for appearing before us. The committee is interested in your point about the transfer of consumer affairs to Treasury. That is an issue that we will take up with other witnesses.

[12.01 p.m.]

CALVER, Mr Richard Maurice, Director, Industrial Relations, National Farmers Federation

CHAIR—Welcome. Is this your first appearance before the committee?

Mr Calver—Yes, before this committee. I appeared before the committee in its former guise some considerable time ago when it was under another name.

CHAIR—I invite you to make an opening statement.

Mr Calver—Thank you. The first point is that NFF's house journal, *Reform*, was recently published, and I have provided the committee with the requisite 10 copies asked for. It contains an article entitled *Superannuation: Drowning not Waving*. That article continues the theme that was introduced in our submissions and that are central to the submissions made to the committee that superannuation, especially its taxation regime, is overly complex and in need of urgent comprehensive review. There is one correction to our principal submission to the committee, and I might point that out initially. That is the figure at paragraph 6.2 of the submission in the middle of page 24. The figure of \$20 per member should be \$2 per member. We apologise for that typographical error. It is still quite a substantial burden for all of the members when you consider that there were, at the time, around 165,000 of them.

The issue of superannuation guarantee compliance is only touched on in the article. It is a more holistic approach. Since the publication of that article, and since our submission, we have been wrestling with a dilemma, and I just want to put the terms of that dilemma to the committee. On the one hand, we have the introduction of the new pay as you go system. That system provides an opportunity to link all employer related responsibilities to one form and one effort of compliance, centred around the completion of a business activity statement. For most farmers, because of their size, this is a quarterly obligation.

We have been considering the issue of quarterly superannuation guarantee payments based around this new focus in business compliance brought about by the new tax system. Whilst it would be easy to merely concede that the quarterly completion of a business activity statement should deal with superannuation compliance by having, say, a component that dealt with an employer flagging the contributions made under the SG legislation, that alone, we submit, is not enough. In other words, there does need to be related reform before the National Farmers Federation believe we can endorse the move to mandatory quarterly payments of SG contributions.

There are quite substantial reasons for that. We say that this is a dilemma because of our background knowledge that the fund with which we have some connection, the default fund for the pastoral and horticultural industries, the Australian Primary Superannuation Fund, holds less than 25 per cent of members' tax file numbers. There is a 75 per cent non-compliance rate. Our information is that that figures unfavourably with general surveys that have been done. Recently we have come across an article produced by a group that call themselves Count Wealth Accountants, Count Financial Group Pty Ltd, where, in a survey of 403,982 superannuation fund investors, they found that 26.2 per cent, or 105,914, did not have their tax file numbers

recorded. That is 26 per cent who did not, as opposed to Australian Primary Superannuation Fund where 75 per cent do not. We also present the dilemma to you against the background of the Australian Primary Superannuation Fund having told us that they needed to return approximately 1,000 cheques received after 28 July in respect of the reporting period ended 30 June 2000. So there is already a fairly high level of non-compliance in that regard.

I would now like to outline the linked reforms that we would like to see introduced contemporaneously to any mandatory quarterly payments of SG contributions. This is a development of the policy, if you like, because the policy was formulated in January. This is a change from the policy articulated in the written submission. Firstly, we believe that mandatory quarterly payments must be linked with a change in the SCG exemption figure that meshes with that quarterly obligation. So \$1,350 a quarter should replace the \$450 per month current exemption level. The NFF policy and the arguments which support a quarterly threshold in that regard are already set out in our principal submission to you, so that is not new. The arguments are at paragraphs 7.2.4 and 7.2.5 of our principal submission.

Secondly, we would like to see the introduction of an incentive based scheme that provides a positive benefit to employers as a quid pro quo for loss of cash flow benefits associated with a once a year payment that they currently enjoy. Perhaps that could be in the form of some element of deductibility for the superannuation guarantee charge. That could take the form of a sliding scale of deductibility: if an employer were one quarter late with payment, the SGC would be 75 per cent deductible and so on until the current situation of non-deductibility for the SGC when the payment was one year late.

The third policy change we would like to see follow the introduction of mandatory quarterly payments would be the reduction in some way of the penalty regime. Reduction or removal of the ATO administration fee applied when there was a SG shortfall would seem to us to be appropriate. At the present time, subject to the introduction of measures that encapsulate those three concerns, mandatory quarterly superannuation guarantee contributions could be supported by NFF. We would like to see those contributions made in a system that we have said long and hard needs to be simpler and that needs to go back to the principal focus of superannuation. So the areas of review that are crying out for reform are the taxation of superannuation and its more effective administration. That is the opening statement.

CHAIR—I note with some concern your low compliance in terms of the TFN and the thousand cheques returned late because of failure to meet the deadline.

Mr Calver—That is in respect of the default fund for our awards.

CHAIR—Therefore the money had to be redirected to the superannuation guarantee charge. But that raises questions about the adequacy of the communications by the fund.

Mr Calver—There were many communications.

CHAIR—But I mean that the effectiveness of those communications with your members does raise some doubts as to whether they are adequate, because other funds with similar types of work forces seem to have a higher rate of compliance in terms of the TFN. Would you like to

respond? Everybody thinks they respond adequately until you compare them against the backdrop of what other people or other funds are achieving.

Mr Calver—There is a number of differences. There was a great deal of communication not only from Australian Primary Superannuation Fund but from our individual state farmer organisations, who have an employers handbook. An employers handbook is taken out by farmers who are clearly indicated to be employers and therefore would have a need to comply with the superannuation guarantee charge or make the appropriate contributions. Those communications are individually mailed. We issued media releases and got a lot of publicity. The wage sheets that we send out for award based matters were modified to take into account that obligation.

However, I think that what we have in relation to rural matters that is different from other sectors is a very large number of employers who engage itinerant workers over harvest periods, and that is even in the shearing industry. If you take the notion of shearing and its related tasks as wool harvesting, we have a large number of products or crops that have to be harvested with basically itinerant workers who are engaged, particularly in horticulture, in large numbers over short periods of time. You might have, for example, a cherry orchard where you have to engage a very large number of people very early in the morning to pick the crop in a small timeframe for its quality. You have to engage them and you have to deal with all of that administration. There might be a very large number of small amounts of moneys that have to be remitted, sometimes with those workers advising names and addresses that are not entirely complete. That is what Australian Primary Superannuation Fund suffers from: having a large number of notifications where name and address details are not complete. It has to follow them up. The administrative burden in that area is such that the farmer or the grower wants to do the administration in one hit at one time of the year. The administrative burden, I would say, is out of proportion to that of other employers, because of that small harvest period when a very large number of itinerant workers are engaged. We find that compliance burden in relation to employer obligations is mirrored in other areas.

CHAIR—These itinerant workers do not come within the exemption threshold?

Mr Calver—Some do but generally you can only claim the tax-free threshold from one employer. If you are itinerant, it is quite difficult sometimes to choose that.

CHAIR—But some sort of superannuation guarantee, if they are not earning very much money?

Mr Calver—The \$450 a month sometimes kicks in, but generally it would not for a lot of those people. It is quite easy if you are a very good pieceworker, harvesting fruit and vegetables, for example, to earn that much money quite quickly if you are a very good picker. Certainly, shearers generally would earn, as you know, well above that \$450 in a month. That is the reason that the Australian Primary Superannuation Fund has many more small contributions than most other funds. That is why the burden of compliance is that much greater—because you have got a larger number of members with smaller amounts of money.

CHAIR—There does seem to be some problems about crosschecking with the fund in terms of people who are over 65. As you know, they have to communicate with their fund on a

monthly basis. The fund does not really seem to take that responsibility too seriously. They just pick up those amounts without checking what the employer has done. Even if the employer is contributing regularly, there is no such crosscheck. We have instances where they pay that money on a quarterly basis straight into consolidated revenue, and according to the act they are perfectly entitled to do so.

Mr Calver—Yes.

CHAIR—Again I would say: bad crosschecking, bad communication.

Mr Calver—We understand that large industry funds have a pilot arrangement with the ATO to facilitate, interrogate and match lost members against the SHAR. We are not sure how that is done, but we assume that is by sorting tax file numbers provided by the fund.

CHAIR—No, in this case, there is no problem with tax file numbers. The person has been employed for over a dozen years and has turned 65, and there is an obligation to report on a monthly basis. Of course, you can imagine people get a bit sick of that. When they know they are regularly employed and the employer is contributing regularly, the fund still pays the amount straight into consolidated revenue on a quarterly basis.

Mr Calver—I understand the example you were making, I was trying to make another example in our experience where there is a need for greater crosschecking. I am sorry if I did not make that quite plain. What we are concerned about is that there needs to be some sort of consultative process where the ATO might accept direct payment from scores of farming employers who paid their SGC directly to the ATO with the administration fee, instead of them directing those to our default superannuation fund under award provisions. Any better matching that can be made in that regard would be most welcome because, ultimately, that money should end up in a fund for the benefit of the workers, if it is being paid, rather than paid direct to the tax office. We go into that in some detail in our submission. If there could be a better means by which those moneys could be directed, we would not end up with the number of unclaimed vouchers that we have and, if there was a better matching process that could be recognised, that would also be fruitful for both the ATO and for superannuation funds. With respect to matching all along the way—both at a point where the members has to communicate with the fund and where the fund has to communicate with the ATO—there maybe needs to be a look at the ways in which the privacy laws can be overcome to deal with that and, at the same time, how the compliance burden can be reduced on the fund. For example, if the ATO knows that the employer is in a particular category and they are notified of the default fund that currently exists in respect of those moneys, it would be a better arrangement for getting those moneys into a fund than is currently being administered by the ATO.

CHAIR—But don't you think there is an obligation on the fund to check for these sorts of workers to make sure that they are actually in continuous employment?

Mr Calver—That is an obligation that is just not possible with the number of itinerant employees that work in agriculture, for example, or the number of itinerant employees who might work as shearers for six months of the year and then go back to their own farm and farm or go and work in an abattoir.

CHAIR—It is not very satisfactory if they are over 65 and they just send it off to the tax office, because they are not earning any interest on that basis, are they?

Mr Calver—No, we do not want the moneys to be sitting in the ATO when they can be in the funds earning money for the benefit of workers, whether they are 65 or not. Chairman, I think we are absolutely in agreement in that regard.

CHAIR—There have also been instances of the private sector coming in and saying, ‘If you want your money back, give us \$1,000 and we will get it for you,’ which seems a bit rough. They are getting back their own money.

Mr Calver—Absolutely. I think a better matching process—that was the point I was making—between the ATO and default funds would assist that process markedly.

CHAIR—But not only with default funds; your particular fund runs into that problem.

Mr Calver—I think so, but the reason I mentioned default funds is that they are articulated; they are public knowledge. They are there for the world to be aware of when there is a payment under an industrial instrument. Generally, in agriculture and other sectors, those funds are quite palpable and it is quite easy to access what the name of them is. There was a matching process which allowed the ATO, in respect of moneys received and with particular funds, to run TFN checks and say, ‘Yes, we do hold moneys for 35 of those for whom you currently receive contributions.’ That matching system would be far more efficient in getting moneys into the complying fund and therefore earning interest for the worker, getting it into the hands of the worker.

Senator ALLISON—Can I just clarify the practice of payment of SG by your members? Do the vast majority of them pay annually because they are able to, or is it like other employers who vary from monthly payments to quarterly to annually?

Mr Calver—Very few would make monthly payments. Most of them would make quarterly payments. We did a sample survey of Australian Primary at the end of the last period and 28 per cent made annual payments.

Senator ALLISON—Could you characterise those?

Mr Calver—No.

Senator ALLISON—Which groups of farmers are having difficulty with the more frequent payment?

Mr Calver—Unfortunately, that detail was not available. The conclusion we have come to is that it is those who engage either a small number or a large number of itinerant workers, itinerancy being the principal factor.

Senator ALLISON—I would have thought it would have made more sense, if you had a high number of itinerant workers, to go down the monthly payment path.

Mr Calver—Not if the amounts in respect of each are small.

Senator ALLISON—But, if you employ them only once a year, the problem does not go away because you made the payment at the end of the year.

Mr Calver—No, that is true. That might well be a cash flow issue—for example, not being able to make those payments until you get your wool cheque. I think a lot of administration and payments in the wool industry are consonant with the date they get their wool cheque, which means that your cash flow is linked to around when you are going to get paid for the wool. Unfortunately, with the state of the wool industry at the moment, that wool cheque quite often does not extend to all the payments that you need to make, with ABARE forecasting minus \$30,500 as the average income for a wool grower in the last financial year.

Senator ALLISON—Does the discounting that you spoke about a little earlier relate to charges for non-compliance?

Mr Calver—What discounting, Senator?

Senator ALLISON—I made some notes, but you were speaking too fast for me to pick it all up.

Mr Calver—I am sorry.

Senator ALLISON—You said that if you are a quarter late there will be a 75 per cent deduction. Can you spell that out a little more? I point to the fact that, in your submission, you urge less complexity rather than more. It seems to me to be a quite complex system you are proposing.

Mr Calver—Again, I presented it as one of the ways in which we see ourselves getting out of a dilemma. You have postulated another dilemma—that is, in order to have a scheme where you get some positive benefits to employers as a quid pro quo for mandatory quarterly payments, does the legal regime have to be more complicated? Unfortunately, I think it does. What I am suggesting is that, at the moment, the superannuation guarantee charge is payable if you do not get your moneys in by 28 July to the superannuation fund. It is a once-a-year matter. It is completely non-deductible. If there is a move to quarterly mandatory payments, the idea is quite simple—manifestation of the legislation might not be—if you are one quarter late then, obviously, you would get a 75 per cent deduction for the SGC.

Senator ALLISON—That is a tax deduction?

Mr Calver—Yes. If you were two quarters late, you would get a 50 per cent deduction; if you were three quarters late, you would get a 25 per cent deduction. If it were back to where it is now and you were 12 months late, the position would be consonant—that is, the whole of the SGC payment would be non-deductible in income tax terms. It would become a stepped non-deductible tax instead of a completely non-deductible tax. Some taxes are tax deductible and some are not. Fringe benefits tax is tax deductible but the SGC is not. This would be a way to phase in the non-deductibility of it. When you say the numbers like that, it does sound quite complicated but I think that, conceptually, it is not. We are already very concerned about, as you

say, the complexity in superannuation. We think there are lots of ways in which that can be cleaned up fairly quickly. The taxation regime is crying out for reform in respect of simplicity.

Senator ALLISON—I wonder if your members have come across cases of fraud and whether, in your view, there are adequate prevention mechanisms in place for that whole area.

Mr Calver—I will take that question on notice and will give you a written response.

CHAIR—How many of your members have been asked not only to pay the contributions charge but also to remit the amount as well to the tax office?

Mr Calver—That is, members of the NFF who are members of the Australian Primary Superannuation Fund? I am just repeating your question to get it clear. That is the charge that they would have to pay under the award arrangements. We would have no way of quantifying that. I can pose that question to Australian Primary. We would have no way of knowing that figure unless there was a file opened by one of our state industrial officers to assist with the administration of that. I do not know whether that is a figure that would be reported to the fund either because the fund might not know that they had paid the charge instead of paying the moneys in.

CHAIR—It is a fairly contentious issue that I thought might have come across your desk.

Mr Calver—I can make inquiries of the Australian Primary Superannuation Fund with whom we obviously have a very cooperative arrangement.

CHAIR—We have six to seven million workers in Australia with about 20 million accounts, and a population of 17 million. That is not really going to go very far in terms of covering everybody for a retirement income, is it?

Mr Calver—No.

CHAIR—Have you got any solutions to that issue?

Mr Calver—That is the point we make in our submission. Some of the solutions are put quite discursively in the article that we tabled: start with a review, get rid of the BAD tax aspects of the superannuation system—

CHAIR—That is the contributions tax?

Mr Calver—That is partly it. To have tax levied at the stage of benefits only rather than taxing it at all three stages, and to do that against an adequate assessment of whether or not there are truly concessional arrangements for superannuation at the moment. In the article, we cite—under ‘Reform’—a study that is being done by the Institute of Actuaries, Australia. The study has been going for about 18 months. They have not been able to publish the conclusions yet, but it will be available towards the end of this year. That is in footnote 19 that we mention that study. Without an assessment of whether or not the concessions that are touted as benefiting the wealthy are in fact achieving that purpose, or whether or not superannuation is truly

concessionally taxed, it is difficult to see how that review might start. Certainly, our focus is taxation at the benefit stage.

The other issue is the finding by researchers not connected with us but in a study published by the National Australia Bank that most of the lump sums were being used to fund early retirement ahead of receipt of the aged pension and that most of the increase in lump sums that people were able to receive had gone to that purpose. So consonant with taxing benefits would be ensuring that rules were in place to complement that issue of taxation—that is, to have more people who accept the pension option. Both of those broad reforms would benefit the system markedly. We are saying that there appears to be a misconception that superannuation is overly concessionally taxed. We are anxious to see the study by the Institute of Actuaries, as I am sure most people are, which actually quantifies that. We would like to see more discussion amongst all of those who represent employers, in particular, of options to transform superannuation.

One of the choices that ASFA has put up is floating the idea that government should abolish the 15 per cent contributions tax in exchange for employees contributing a further one per cent of their salary to superannuation. We mention in our *Reform* article that part of the problem with that is the constitutionality of it—how you would actually require employees to produce those moneys. The other is the fact that it may not benefit everyone in the same way. So if that were to be implemented, we would want a member contribution sliding scale. For example, those under the \$6,000 taxable income would be required to pay nil; those between \$6,000 and \$20,000 would be required to contribute, say, one per cent—these are all very rough figures at the moment that have not been endorsed by our council, but they are the sort of argument—\$20,000 to \$50,000, two per cent; \$50,000 to \$60,000, three per cent; and \$60,000 and above, four per cent. So there would be some recognition, if you were going to have that compulsory employee contribution, of their own income. I am sorry, it is a very long-winded answer to your question, but I could talk for some time about the way we have looked at the systemic problems and some of the ways in which we think they could be changed for the benefit.

CHAIR—Thank you very much for appearing before the committee this morning. You might like to raise the question of internal communications.

Mr Calver—We will. I will take those other two questions on notice and write to you.

Senator HOGG—Does the number of vouchers represent a number of people, or does it represent a multiple number of vouchers per person? Do you have anything to indicate what the situation is?

Mr Calver—The figures in the taxation statistics, from which those tables are derived, break it down into both. Let me check my notes, because we did do a fairly detailed analysis of that once those superannuation statistics were published. The table that appears there is the number of vouchers, not the number of people. There is a separate table in the superannuation statistics from which that table is derived—that is, *ATO Taxation Statistics 1997-98*. There are various tables that also show the number of people. That is in our supplementary submission with some more detail about that that you already have.

Senator HOGG—You have the same table in your supplementary submission.

Mr Calver—I apologise.

Senator HOGG—That is fine. I was curious if you had any insight as to the number of people who were involved in those vouchers.

Mr Calver—If I had brought the original statistics, there may well be some disclosure of that but, for the time being, no. We are concerned about that because of the number of our people who are itinerant. I do not have any figures on numbers with me.

Senator HOGG—Is there any relationship between the outstanding number of vouchers and whether or not those people are of a non-English speaking background?

Mr Calver—If the ATO has given evidence to you, I think the disaggregation of those numbers would be very interesting. Those are the sorts of questions we would like to see answered as well. We would like to see answers to the question of not only non-English speaking people but also a sectoral breakdown.

Senator HOGG—Do you have a gut feeling?

Mr Calver—No. We know from our experience with the Australian Primary Superannuation Fund that, in agriculture, we are disproportionately represented in those numbers. But there is no further disaggregation of those statistics by the ATO that have been offered to us, even though we had some preliminary discussions with them about that issue. We had hoped that, out of this inquiry, some more details about vouchers would be published.

CHAIR—Thank you, Mr Calver.

Mr Calver—Thank you.

CHAIR—Is it the wish of the committee that the spring 2000 edition of *Reform*, a quarterly publication of the National Farmers Federation, be accepted as a tabled document? There being no objection, it is so ordered.

[12.36 p.m.]

FREEMANTLE, Mr Jim, Chairman, Australian Association of Permanent Building Societies

LARKEY, Mr Jim, Executive Director, Australian Association of Permanent Building Societies

CHAIR—Welcome. We invite you to make an opening statement.

Mr Larkey—Thank you very much, Mr Chairman. We made our submission to the committee on 24 March, and we have approached the committee on the issue of the funding of prudential supervision which we interpreted to be under your terms of reference. When we made that submission, Treasury, at the direction of the minister, were reviewing levies for the payment of the prudential system. At that point, we did not have their report. Since then, a report has been made, and we were singularly unsuccessful in having our case favourable considered by them. We approached the Senate committee even before we knew that—maybe we had a premonition of it—

CHAIR—Do you know of anybody who was successful?

Mr Larkey—The foreign banks were very successful. The locals did not do terribly well. We might come to that later.

Senator HOGG—Why were they successful?

Mr Larkey—They got a levy, 50 per cent of the levy that they were previously going to get.

CHAIR—What was the basis of that concession—give it to them and not to the poorer customers in the building society movement?

Mr Larkey—The rationale provided was that, because they were subject to prudential supervision in their home country—be it Germany or wherever they might come from—the burden of prudential supervision on their subsidiary in Australia would not require as much time and effort by APRA. The irony of that concession is that, in effect, the levies on the other deposit taking sector were somewhat increased. That does not matter for the top 10 largest banks but, as a consequence of that gesture, it all meant that it was at the expense of the building societies, the credit unions and the regional banks that were currently below the maximum level. It did not affect the large banks, because they pay the maximum levy anyway. So there is a certain amount of irony in that.

CHAIR—How much did your levy go up by as a consequence of that?

Mr Larkey—Our levy did not go up but our levy did not go down as far as it should have as a consequence of that. We are not really complaining about the quantum of levy that we pay or the quantum of the cost of supervision in respect of APRA. Our concern is how the burden of levy is shared. The present system means that if you are a very large bank it does not matter

what happens; you pay the maximum levy. If we grow in excess of inflation, for example, every dollar that we add to our balance sheet is punished very severely whereas, in the case of the larger banks, if they grow in excess of inflation—and they certainly did last year—it does not matter anymore. So as we improve our performance, as we grow and improve our market share, we are being levied more all the time whereas the majors are not. This maximum levy was put in legislation. That is why we would recommend or suggest that the Senate have a particular interest in it. It is not the function of APRA to set or comment upon the maximum and in submissions they have made and in appearances before another committee they have said, ‘That’s a matter for the parliament and the Treasurer.’

We are really between a brick and a hard place because the advice that we get is that the maximum was set originally because parliament likes to set maximums on money raising activities or levies of this sort. The argument put to us was that a maximum had to be set because that is what the parliament wanted. So we are coming to the representatives of the parliament for them to relook at that and to ask the Treasurer to relook at the maximum. When the maximum was set, the new prudential arrangements and the new supervisory arrangements of ASIC for consumer protection affairs were not in place, and nobody knew what they would cost. A million dollars sounds like lot of money but, be that what it may, the maximum penalises severely our institutions and everyone who is relatively small.

As you know, we operate primarily in housing finance. At the present time we are operating at between 12 and 46 basis points lower than the major banks on the traditional home loan product. These are fairly small numbers in differences, but you can see how crucial it is that all our costs be examined very closely as to whether they are reasonable and fair. Obviously, if we are competing with the majors—and I am submitting that we are competing quite well on the major product we are involved in—we are being penalised for doing so because of this anomaly of the levy maximum. We are submitting that your committee might like to consider that, because it is really not within the responsibility of APRA or ASIC; it is really the minister’s responsibility. It was said in the Treasury report which came out that the larger institutions did not agree with that, the small institutions wanted this and, in view of the fact that there was no agreement on the maximum levy, no recommendation or decision was taken. That is in the Treasury’s report on levies, which was not widely publicised but it is a public document and is available. It is not just the building societies, let me say. There are also regional banks such as Adelaide Bank and Bendigo Bank. In my submission we show that a bank with assets of \$124 billion—such as National Australia Bank—pays a levy of \$1 million. On the collective assets of the building societies, which are 10 per cent of the size of NAB, we are paying \$1.6 million.

A bank like Bendigo, at the time we made our submission, was paying half a million based on assets, and that means customers and depositors, of \$4 billion, whereas, the National Australia Bank, for example, was only paying twice that—with assets of umpteen times that. You can see our concerns. The building societies and others have been quite persistent in this argument, and have charged me and Mr Freemantle with the obligation of trying to get some rational thinking and some fairness into the scheme. The government is very keen to promote and foster regional banks and community banks, but here is a case where their actions do not match their rhetoric. That is our particular case.

CHAIR—You share that sort of problem with the smaller super funds, who have problems with their charges to APRA compared with the giants?

Mr Larkey—Yes, they do have a similar problem. We are categorised into the deposit taking sector category. The deposit taking institutions are subject to a higher level of prudential scrutiny than the other sectors. Really, I am arguing that that is a problem for them. In our group, which is deposit takers, we are in the same group as the major financial institutions in the country, and we would have thought that we would have been looking at supervision on the basis of the depositors protected and on the basis of the assets used to generate the payment of the levy. Some regard must be had for size—a bit better than what it is.

CHAIR—It was said that the banks have met the competition from the mortgage originators and others, and brought their charges for interest back. Has that affected building societies significantly?

Mr Freemantle—Yes, it has. The whole market has had to work on very considerably less margins than it had previously as a result. Notwithstanding that, the buildings societies, as Jim Larkey has said, are operating generally below the major banks' housing loan rates. Very obviously, borrowers for housing have benefited across the board. We would argue that is a good thing, particularly as that is the principle area of our business. One other thing that might be borne in mind with the building societies—and also the credit unions, although they are quite capable of arguing for themselves—is that not only are we operating perhaps below the rates charged generally by the major banks in a lot of cases but also we are providing a low fee alternative. There has been a lot of criticism of the major banks in their fee charging—rightly or wrongly. The building societies do provide a low fee and, sometimes, a no fee alternative.

This reinforces our point that, as we tend to give benefits to our members 'below and above the line' and we are not answerable, generally, to shareholders, any imposition of additional cost comes from a smaller profit level from which to absorb it. Hence, the levy issue—and any other impost—is important to us. The philosophy of Wallis, which was enshrined in legislation and got bipartisan support in the legislation that followed, was based on a level playing field argument and providing competition for a lot of the entrenched mainstream banks. Hence, if we are going to have that level playing field, this is one impediment that could be removed. By seeing a fairer levy system, not only as of today but if we had, say, a change in government policy and a merger between two larger institutions, theoretically \$2 million could become \$1 million overnight. One could argue that changes will be made then but I would rather see the changes made and a formula established that took that into account and we were not scrambling round ex-post to try and remedy something.

CHAIR—So building societies have a lower cost structure than banks, do they?

Mr Freemantle—No, they do not. I think that, in terms of cost to income ratio, they are probably considerably higher than the banks. Their cost of delivery of services is higher, largely because they would have a higher ratio of staff to their membership base—their customers—than the banks, quite deliberately and because one of our differentiating points has been the level of personal service. I think, though, that the real difference is that we do not have quite the revenue streams because we have not imposed the level of fees and charges and we have tended to charge slightly less on our loans. The cumulative effect of that, of course, comes straight off profit. Profit is not the be-all and end-all of the mutuals, because it is argued that really we only need sufficient profit to retain confidence in the organisations and to augment our capital base

so we can grow; other than that, our benefits can be returned, rather than as dividends to shareholders, as rebates to members.

Senator HOGG—Just what sort of structure would you envisage? Would it be a two-tier structure—where the majors are paying a certain levy and with a differential levy to the others? Or do you see it being a fixed amount that is allocated for APRA, and then it is divided up proportionately amongst all the player? What sort of model do you see working?

Mr Freemantle—I would argue for a model that took two things into account: not only just the overall size of the organisation but the complexity of it. I would like to see the maximum removed. Let us take one of the major banks like the National Bank which has operations in London, America and Asia: it is involved in very complicated areas which, in terms of prudential supervision, are areas that need watching—dealing operations in a number of quite exotic products and in very high volume and large numbers. As we are all aware, when something goes wrong in a dealing room, like the Barings Bank incident in Singapore, the losses can be horrendous relative to the size of the institution.

Building societies are relatively simple organisations; most of their assets consist of mortgage secured assets and cash or near cash. Therefore their depositors, who provide the funding for that, are really pretty well protected. They are very simple, in a prudential sense, to supervise. Most of the supervision can take place in terms of the returns that we put in periodically to the supervisor, who can monitor what is going on. Therefore there is an argument that, of all the organisations that require little supervision, building societies are probably it.

Banks involved with significant exposures offshore and in complicated areas of foreign exchange and capital markets dealing require a great deal more supervision. Therefore you may even see a curve of fees that sees them bear a very significantly greater proportion of supervisory costs. I would argue that that is where the regulators would be having to spend most of their time, both because of the nature and complexity of the risk in those organisations and also because of the systemic threat that if one of those organisations gets into serious trouble then there are ripple effects—and they would be more than ripple effects—right through the financial system in Australia. Whereas, if a building society got into trouble, there would hardly be a ripple. I think there are two arguments to say that the major banks should bear a very much greater share of the cost of prudential supervision.

Senator HOGG—Do you have an actual mathematical model in mind, or just the general principle?

Mr Freemantle—I have not and I do not; but I agree it could be easily constructed.

Senator HOGG—Arising out of your answer, what is the experience overseas? I have no knowledge of the situation in other nations. Are major players confronted with the same situation?

Mr Freemantle—The UK, which has a well-developed building society movement as well as a well-developed banking sector, is going through the same arguments about equity in terms of the spreading of supervisory costs—without a full conclusion. Jim, you might like to comment on the latest from the UK.

Mr Larkey—I only received some information last week about the UK. The Financial Services Authority is just being established there, and they have yet to finalise the basis. The information that I have received from people who are discussing it with them is that the Financial Services Authority considers that it would be inappropriate to set maximum fees. They have also grouped the deposit taking institutions into the one category in the UK. If the UK is taken as precedent as to what Australia might think about, we would have no maximum; the levy based on either retail deposits or total assets; and the deposit takers put together. And that is our recommendation. The argument of a major bank would be: ‘We could be paying millions in levies. That is unfair.’ But that is one of the burdens of being big. You generate your profit on the asset base, and to have a maximum is always going to be unfair. As Mr Freemantle was saying, you do not need 10 or 15 PhDs in finance to prudentially supervise building societies. We did suggest and the Treasury report recommended that APRA look at ways of producing detailed specific activity cost information which would assist with the setting of levies in the future, in a way that better reflects the cost of supervision.

Senator HOGG—Has that been done?

Mr Larkey—I understand the Treasurer has written to the chairman of ASIC and the chairman of APRA as a result of the inquiry. There is nothing on the public record, but no doubt they would be doing that. As I said at the outset, our problem is not so much the quantum that it costs to run APRA or ASIC to a certain degree but the sharing of that cost. At the present time it has been difficult for the new organisation to set up costing records within it. In their evidence to another committee of the parliament, this matter was traversed.

Senator ALLISON—You suggest that there is a high level of risk in the major banks and, in point 2, that it is higher than in building societies if one went wrong. Has APRA or any of our supervisory organisations actually accounted for their efforts in particular sectors? Does that support your argument? Or is your argument more about what might happen with a spectacular crash with one of the banks?

Mr Freemantle—I think that it is both. To my knowledge, there has been no work done that has been released by APRA to say how much time they spend on various aspects of their supervision. That is the first part of your question. The second part as to the implications for the future is valid. That is part of my argument—that, because of the inherently more risky nature of a bank compared with a building society and the size of the banks, the danger to the financial sector if one of them did get into serious trouble would be that APRA would be likely to spend far more time in the supervision of those sorts of activities for those sorts of reasons. Hence I would suggest that, when any sectoral analysis was done, a greater part of APRA’s time—and of its more skilled time and therefore more costly time—would be spent in the banking sector in the more exotic areas of it.

Senator ALLISON—Yet we have not yet had a spectacular crash in the banking sector but we have in a building society, with Pyramid. Without going into all of the ins and outs of Pyramid, does that not suggest that there at least needs to be careful supervision of building societies?

Mr Freemantle—Yes. That was a valid point at the time that Pyramid was extant. As a result of that, some significant lessons were learnt and AFIC was set up and the state supervisory

authorities were restructured to take account of that. Now, under APRA, all of us are prudentially supervised and I would suggest that the chances of any serious trouble within the building society movement is remote. I would also hasten to say that I am not for a minute trying to suggest that there is the potential or likelihood of a major Australian bank getting into trouble. I am simply saying that the supervision required is greater to ensure it does not happen and to look at those areas where it is most likely to happen, which is certainly not in the banks' mortgage portfolios.

Mr Larkey—If I could add to that, against the background of the maximum levy, I think we would be arguing that if there was not a maximum levy payable, we would not have any difficulties at all. But given there is a maximum levy, and we have not been successful in convincing the Treasurer or the parliament to suggest a change, we then get forced back to asking, 'Where is the expense expended?' What we are saying is that the complexity of dealing with the major financial institutions requires APRA to have highly skilled people to do it. To deal with the complexities of our organisations, they do not really need that many. So if the things were costed as to why we need someone from a highly qualified area and a whole team in this area, if it is being used primarily to nut out the complexities of the finance market, we should not be paying for it. Because there is a maximum, we are forced to look at the nitty-gritty of APRA. We would rather not get involved in that. But if the funding were on an assets basis—which is what they are going to do in the UK—and that is the basis on which the financial institutions generate the income to pay all of their expenses, I cannot see anything more reasonable, favourable and equitable than that structure.

Senator ALLISON—So you would recommend that the committee request from APRA those sorts of details, or do you think they are not able to be sourced without a different process in place?

Mr Larkey—There are two points there. We are really asking the committee to recommend to the government that they change the levy from a maximum levy to, as they are going to do in the UK, a levy on assets or on deposits. On the question of asking APRA to do one thing or the other, we certainly do that and we have regular meetings with them. On the question of accountability, both APRA and ASIC benefit from the total levies. They report to the parliament and to the Treasurer, who reports to the parliament. They do not report to the people actually paying the levies in terms of what they do with the levies. We would suggest that that is probably not the most desirable outcome. In other words, we would think that those receiving the many millions of dollars have some sort of accountability to the industries paying those levies.

I am not suggesting that the members of parliament would not look at them as vigorously, but people who are paying for something always look at something more vigorously than people who are not paying for it. This is particularly the case in respect of ASIC. Their new job under this new arrangement is consumer protection, and that is being funded in part by our levy. That is fine, but there is no accountability and the protection of consumers is not confined to those financial institutions paying the levy. Finance companies do not pay a levy, and consumer protection activities of ASIC will apply to them, so we have a case where we have been levied as a result of other changes. There have not been changes at ASIC to provide them with any additional fundraising capacity to look after the consumer protection issues of non-levied financial institutions, and we think that is tied up with the accountability issue. Again, we are

not suggesting for a moment that the money is not well spent. That is not our case. Our case is that, like with everyone, it should be subject to at least some reasonable accountability to the people who are actually paying the levies. If that were the case, we would obviously subject them to the interrogation that we get subjected to, from time to time, from the people whose money we are spending.

Senator ALLISON—So do you think APRA should appear before your organisations and that you should be able to ask them questions? How does that accountability work?

Mr Larkey—Yes. I do not see why not.

Senator ALLISON—Presumably, the report to the parliament is also available to you, so you can read it.

Mr Larkey—Yes, it is.

Senator ALLISON—What sort of accountability measures would you like to see?

Mr Larkey—In practical terms, that is what it would be: the boards of those two commissions would convene a meeting of levied institutions and report to them.

Senator ALLISON—Is there a precedent for that to happen that you are aware of?

Mr Larkey—Not that I am aware of. Again, I revert to our colleagues in the UK: this was a proposal put by the UK financial institutions on the basis that they were going to be subject to a levy. I have not followed up as to what has happened to that but I think you can see the problem—if we had a concern with APRA or ASIC, we would have to come to a member of parliament for them to ask the questions. There is nothing wrong with that.

Senator ALLISON—So is this just an argument to support your case for a change to the cap arrangement, or are there other questions you would like to pose to APRA on an annual or a somehow regular basis? And if so, what are the sorts of things you do not get answers for now that you would like answers to?

Mr Freemantle—I think that accountability would be a good thing, particularly as we have moved into a new supervisory regime. I know that one cannot hold people to things said earlier, with the best intentions. One of the earlier comments about the change post Wallis from one of the members of that committee, who was also the chairman of AFIC, was that he was confident that it would reduce the cost of supervision by some considerable amount. That has not quite transpired but I would not hold that against him as events unfolded. Generally speaking, as far as the regulator is concerned, the communication with APRA on regulatory issues has been good. I would not criticise them or think that they have done anything high handed without consultation with the industry. I think they have been pretty good about that. So I would not be concerned about the relationship between supervisor and supervised institutions. On the financial side, yes, I think that it would not be a bad idea perhaps for them just to account to us for the way they are spending that money in the broader sense.

Mr Larkey—I would like to add to that. When the bill was introduced, the Treasurer made a significant point that, when justifying the levies, those subject to the levies and actually paying them will have the biggest long-term interest in the efficiency of APRA and ASIC. In proposing the legislation, he said:

This method of funding may also tend to encourage the institutions paying the levy to act as a constraint on empire building or other excessive cost increases on the part of the regulator.

That is in the explanatory memorandum of the financial services levy bill. I would need to check whether the Treasurer actually said that.

CHAIR—Are you saying that that has not been met?

Mr Larkey—No. We are trying to exercise the long-term objective, and we have only been in the system for two years. But I am just quoting to you what the government said in presenting this levy information. On the question of accountability, if that paragraph is going to mean anything, then what is the process? It is sometimes difficult for those who are regulated to complain individually to those people who regulate them. Even the biggest financial institutions in the world are reluctant sometimes to criticise or call for accountability. So I think it would be in the interests of both commissions to have a structure whereby, when they produce their annual report, they go through a process of talking about that report and the financials associated with that report. That at least gives those regulated and levied the opportunity to say something if they want to say it. Whether or not that is the answer to the question, I do not know. But in response to your question, Senator, I go back to what the government's policy was, and I think it is true—

Senator ALLISON—I suppose what I am trying to get at is whether this will just be a nitpicking exercise when you question stationery costs, or whether your organisation has a view of the emphases or the focus that APRA is putting on certain investigations. At what level do you think it is important for you to have input?

Mr Freemantle—I think that is really getting to the point of this. No, I do not think there is any point in worrying about stationery costs. If we were getting down to nitpicking, the whole purpose of the exercise would be totally lost. You raise an excellent point. We are more concerned about the building of a bureaucracy. 'This is why we need a whole lot more people in compliance and we need a whole lot more people to do this—We are now going to want you to tell us this and tell us that. We are now going to control this and control that.' I think that is the stage at which we would like to have some input—to say: what is the real point of further supervision of something perhaps on the basis of 'if it ain't broken, don't try and fix it'? There is always a tendency for these things to develop lives of their own and, with the best will in the world, they do. The level of accountability I would like to see is that, if it is necessary to expand the roles or expand significantly in any way the roles or intensity of supervision, there should be some significant interplay with the industry as to why this is necessary and what it is trying to address.

Senator ALLISON—I am sorry to keep pursuing this point, but it is fairly interesting. Wouldn't you again be put at a disadvantage if that were the case, because the banks—ANZ, CBA and NAB—all have a great deal more to call on in terms of resources? I can imagine this

being bigger than *Quo Vadis* with legal representation. Wouldn't you again be behind the eight ball in terms of those major corporations?

Mr Freemantle—Once again, if it gets to that, we have lost the point of it. I think you are showing up a lot of the really difficult areas, even in basic accountability to parliament. I guess parliamentary committees have the same problem in inquiring into these things—where it stops and starts and then how organisations respond. Once it becomes legal and lawyers are starting to argue about it, once again, we have lost the point. Certainly, with APRA, our experience has been that they have been quite cooperative in the way they have dealt with us in the various sectors of the industry—hence I think that it could be kept to a sensible formula whereby we could have some input or they were accounting to us for what they were doing and why they were doing it. If it gets off the rails, once again, you would have to review it. I feel that there would be enough goodwill on both sides in that sort of context for it to be to everyone's advantage, including APRA's, to be fully explaining what they are doing and why they are doing it. That has been their practice to date in a lot of areas and it has elicited pretty positive responses from the supervised.

CHAIR—Thank you very much, Mr Freemantle and Mr Larkey.

[1.13 p.m.]

STARKINS, Mr Anthony Hamilton Tom, Managing Director, First Samuel Ltd

CHAIR—Welcome, Mr Starkins. Before you make an opening comment we would be interested in hearing why you chose the name First Samuel and whether it has any special reference.

Mr Starkins—I chose the name First Samuel because my favourite biblical verse is in the *Book of Samuel I*.

CHAIR—Could you enlighten the committee a little further?

Senator CONROY—Or we could look it up ourselves.

Mr Starkins—That particular verse refers to the fact that the Lord says, ‘Those who honour me, I shall also honour.’

CHAIR—Thank you; that is very appropriate. We invite you to make an opening comment.

Mr Starkins—The government has recognised the need to have high standards of prudential governance in Australia. That regime governs our financial institutions, the Reserve Bank, Treasury and the legal framework that governs corporate behaviour, including the Corporations Law. It was this regime which was rightly held out to be one of the reasons we escaped the worst of the Asian financial crisis meltdown. At the top level, the fiscal regime in Australia is well managed. It is prudentially supervised, regardless of who pays for that prudential supervision, and there is considerable transparency. However, I put to you that swimming beneath the surface of that is an unhappy practice in the retail financial services area. It must be amusing to the international observer to notice that you have all these good things at the top yet underneath to see the reliance on self-regulation.

There is little point in having the world’s best practice at one end of the spectrum and yet having practices that, in some cases at the other end of the spectrum, would do credit to an Indian cricket bookmaker. My case is twofold. Firstly, why should the paying and receiving of commission be made illegal in the retail financial services? It is quite simple that the client, in seeking financial advice, should expect that advice to be absolutely impartial and without the provider of that financial advice having inducement to recommend products which may not be in the best interests of the client. Secondly, why as a matter of policy must the government enact black-letter law to regulate the aspects of this market?

CHAIR—Could you say that again; I missed that.

Mr Starkins—The first point is looking at the commissions area itself and the second is why the government needs to regulate what is known as black-letter law to outlaw this practice.

CHAIR—That is your belief?

Mr Starkins—Yes. The first area in terms of the financial practice of the payment and receiving of commissions has been well set out in the submission that I presented to you. It relies essentially on the fact that there is a fiduciary relationship between the financial adviser and the client and that, as such, with the fiduciary relationship the adviser must act for the sole benefit of the client—and the receipt of commissions is clearly not acting for the sole benefit of the client.

With regard to black-letter law, I draw senators' attention to two precedents where black-letter law has been enacted to bolster a regime of what is also known as 'fuzzy law', or the law of good intentions. The then Companies Act 1961 said that company directors in Australia must act honestly. However, after the Gollin case—which you might remember—where there were directors of companies ripping off the shareholders by taking out loans in their own name, black-letter law was introduced, in 1971, to outlaw that particular practice. Senators would also be aware that in Australia, until 1971, insider trading was not illegal—and it took black-letter law to make it so. Prior to that, insider trading was sort of illegal but there was no specific provision to make it illegal. It was New South Wales law in 1971 and the uniform companies law in 1975 which made that Australia wide. Basically we are submitting that you need black-letter law in this area to tell people what is ethical, because you cannot rely on people's good intentions in this particular area. Unhappily, where money is concerned, love of money is also to be found. In this industry that is the case.

CHAIR—Do you think there would be very much reaction if the committee came up with that sort of recommendation?

Senator CONROY—There would be voodoo dolls of us as well as of Mr Starkins.

Mr Starkins—I think that there would be two reactions. There would be those from the consumers, who would welcome the decision. There are many areas in the Australian retail financial services industry where the advisers do not rely on commissions for their remuneration. They charge what is known as a fee for service—and there is an increasing number. But there are still, at the periphery of the industry, those who rely on commissions to get their business, and it is the latter who will doubtless provide howls of protest to such a suggestion.

CHAIR—Are there any countries in the world that declare these sorts of trial commissions and commissions generally to be illegal in the financial services area?

Mr Starkins—Not that I am aware of, but I would suspect that there are not too many countries in the world that are as advanced as Australia in the development of a retail financial services industry. This problem will doubtless emerge in other countries as they become more developed.

CHAIR—Why are we so far ahead in terms of development?

Mr Starkins—We have the good prudential guidelines at the top and the regulation which covers the market broadly from a prudential sense. We also have legislated growth in the superannuation area with the superannuation guarantee levy.

Senator CONROY—You said that there is a growing number of advisers who are independent—if I can use the definition of ‘independent’, they are not tied in any way through commission. Is that what you were saying?

Mr Starkins—I was saying there was a growing number of advisers who do not charge commissions. Independence is a slightly separate matter.

Senator CONROY—Do you think that, if you were able to stop the financial advisers being tied to just one company, it would make a difference—for example, if they had a choice of two—or do you believe they should not be tied so they can offer a menu from right across the various products that are available from a range of different companies? They could still be paid a commission as long as it was only on the basis that they were not tied—sort of like the mortgage brokers at the moment. It does not matter who they give the mortgage to, they get the same commission from each bank. So it is possible for them to argue that they are not tied to anyone.

Mr Starkins—At the moment there is significant ability even if you are employed directly by a financial services company to recommend products not provided by that particular company. For example, you could be employed by a major trading bank as a financial adviser and provide financial advice and give a recommendation of a product which, in fact, has been provided by a competitor. I hasten to add, as you would have noticed in my submission, this is one of the areas where the most unethical practices do occur. This is where you get a financial adviser working for a trading bank, for example, who if they recommend a bank product receives a higher commission rebate from their employer than if they recommend other products.

CHAIR—Are they not supposed to disclose that?

Mr Starkins—They are supposed to disclose it, and I imagine that they would disclose that.

Senator CONROY—But they would not disclose that they are getting a higher fee. They would say that they are getting X on this product without saying that if they gave you another product they would only get Y.

Mr Starkins—Exactly.

Senator CONROY—So they only have to disclose what it is that they are recommending rather than the things they are not recommending?

Mr Starkins—Correct.

Senator CONROY—You do not see disclosure of that source a solution?

Mr Starkins—No. Disclosure is fine if you are dealing with a sophisticated retail investor. The whole concept of fiduciary obligations reflects that if there was, in essence, no fiduciary obligation between two equals. In these particular circumstances, we would say that someone seeking financial advice clearly is not as well aware of financial matters as the person giving that advice. Disclosure means next to nothing. They do not know what it means.

Senator CONROY—It has been put to me that your definition of fiduciary duty is very narrow and untested, that no-one has ruled in the way that you believe they should rule and that there are no cases that have gone to court that have gone in this direction. Do you have a response to that?

Mr Starkins—I understand that is the case in the financial services area. The aggrieved consumer would find it very difficult to pursue legal action based on a breach of fiduciary duty. In many cases they cannot afford it. We are not talking about situations where people used to sue their lawyers or accountants. They do have a moderate avenue of redress through the various complaints tribunals that have been established and, I guess, can seek redress in that particular way.

Senator CONROY—None of the consumer groups that have appeared before us or that I have contact with have ever sought to take a case like this to try and get the interpretation on fiduciary duty that you have.

Mr Starkins—The reason I took the interpretation of fiduciary duty was to try to establish a legal framework around an ethical principle. You can argue till the cows come home that this is unethical behaviour. How do you legislate for that? What terms do you actually use? Therefore, I decided to take the approach of looking at it from a fiduciary point of view and the responsibilities that would arise from that particular point of view. However, I think you would find a lot of people who would support the concept of commissions being made illegal—so just taking aside the concept of fiduciary responsibility.

Senator CONROY—I am not trying to be unkind, but what you seem to say there is that you have picked up some words in the law and you are now trying to have them interpreted in the way you believe they should be—and you could say a whole range of people believe they should be. I am asking where the case law is to help support your interpretation.

Mr Starkins—There is a reasonable amount of case law in a general sense. I have taken legal advice on the idea of the case law, and you would have seen references to cases in the submission.

Senator CONROY—Yes. Could you take me through the concept of informed consent in a little more detail? A lot of people would say you are talking down to people who go to a financial adviser and that you are saying there is no amount of education you can give people in these circumstances that would really make them on par with the financial adviser.

Mr Starkins—There would be many cases where education would certainly help, but it is an area of financial expertise which does require a lot of understanding, particularly in terms of the impact of the commissions that might be paid and received to influence the decision. You can have someone sitting on one side of the table saying, ‘I fully understand I am paying \$10,000 up-front for this particular financial advice. I know what that means and I understand that that is going to affect my long-term rate of return by five per cent. If you did not have that, then I would have to pay a fee of \$200 an hour for the advice that you give me.’ That is the way some people would see it. But then to ask them, ‘Do you understand that the advice that has been given may be biased by the paying of that commission’ is another aspect, which perhaps is not closely related to knowledge of investments but knowledge of people.

Senator CONROY—In your mind, if I walk into, for example, an AMP office—and I am just picking any company here—or I phone an AMP adviser, have I made an informed decision that I am expecting to have only AMP products sold to me?

Mr Starkins—I think there would be an expectation that the range of products might be biased towards AMP products.

Senator CONROY—Do you think they have a responsibility to look beyond their own products and sell you other companies' products?

Mr Starkins—Certainly. If you hold yourself out as a financial adviser and say that you are acting for the sole benefit of your customer, then you do have an obligation to offer the widest range of products available to that client.

Senator CONROY—Some of this discussion is to do with CLERP 6 and the FSR bill. If I walk into, say, the ANZ bank and some bonds have matured and I have \$10,000, and the teller, as part of the processes they go through, says, 'You've got \$10,000; I should refer you off to an adviser,' would you believe that the adviser should at that point be recommending a product other than an ANZ product?

Mr Starkins—The teller, no; the financial adviser, yes.

Senator CONROY—Even though it is clear that they are employed by the bank?

Mr Starkins—Yes, but they are holding themselves out to be financial advisers giving the best advice possible. If you have a range of products and it is possible that there is a better product out there than the bank is offering and there is a fee involved—the customer is paying for the financial advice—if you do not offer the best product available, then you are not doing the right thing by your customer.

Senator CONROY—How feasible do you think it is for any adviser, especially one that works for ANZ in this particular example, to be able to have knowledge of all the better products?

Mr Starkins—I think it is quite feasible; there is no doubt at all. At the end of the day, most people in the market know what the best performing products in the best particular area are. There is enough research and information around to let them know about that. They should be able to advise on that—otherwise they should not hold a licence.

Senator CONROY—I am thinking in terms of product categories at the moment in my head. If I walk in and I am 21 and I have got \$10,000 and the teller says, 'No, you should go and talk to our adviser over here,' and the adviser said, 'An RSA is the place for you to put your \$10,000 at the age of 21,' I can clearly see that there is some mis-selling going on there. Having had something akin to that in personal experience, I have some sympathy for that argument. But if they were to say, 'This style of product we think is best for you and we are recommending our ANZ one,' then you would believe that they should present it to you with the Westpac one, the Salomon Brothers one, the Citibank one, all of those sorts of things, or just say that there are better earning ones? How do you get around them saying, 'In this last quarter, they are better

performing than us, but over the last 72 years we have been better performed.' There are lies, damn lies and statistics, as they say.

Mr Starkins—There is one easy way to ensure that they get the best recommendations, and that is to ensure that the person giving the advice does not benefit personally from making a recommendation one way or the other. At the moment, if you went to any of the four banks—I understand it is the case with all of the majors—and you were in that particular position, then if you were recommended the bank's internal master fund, the bank's public offer master fund, the person on the other side of the table is going to get 30 per cent more of the rebate from that particular product. If you did not have that practice, then you could certainly at least hope that there was no incentive to recommend products which may not be as suitable.

Senator CONROY—A sign up behind me saying, 'I'm only going to recommend you an ANZ product'?

Mr Starkins—I think if you knew that there was no particular benefit that the person at the other side of the table was going to get in commissions, then perhaps that could be considered. But then they would not perhaps be given the broad range of product advice that they might otherwise get.

Senator CONROY—I have a million other questions, but I will pass over to someone else.

Senator ALLISON—This is a fascinating submission you have made. Was the case study an actual example?

Mr Starkins—Yes, Senator.

Senator ALLISON—Were you able to quantify the loss to the couple by virtue of their signing up to this ill-conceived product?

Mr Starkins—It is something we do not do as a matter of course. It could be quantified; there is little doubt about that. But if we did that then we would be spending too much time looking backwards for our clients rather than looking forwards for them.

Senator ALLISON—It might be useful for us to understand what it means. I guess you are suggesting that there is excessive profit taking through commissions, aren't you, in this submission?

Mr Starkins—There are in some cases excessive profits taken through commissions, there is no question about that, particularly in property or some rural based schemes. That is in fact where you get most of the fancy incentives, as it were. I might just draw your attention to the most recent incentive scheme on the market, which is one where you can receive up to \$15,000 cash by the promoters of the scheme for your dealership, or win the holiday of a lifetime for the sales you make. So this is over and above the commissions you might get. They are now having lotteries to encourage financial advisers to invest in products.

Senator ALLISON—So is there no legitimacy at all in that approach? Could you not argue that the commission system saves a lot of advertising, a lot of other marketing methods that

might be used, and costs, in that you are using the personal approach? I take your arguments on being clear about what your duties are to your client and giving good advice, but couldn't it be reasonably argued that commission selling is just one method of marketing amongst many?

Mr Starkins—It certainly is. I hasten to add that it is a very expensive method because, on the one hand, you have the retail financial adviser who receives the commission and, on the other hand, someone has to pay them and keep track of all the obligations—particularly trailing commissions—and there has to be all of the various other internal mechanisms that go on to support that system. So there is a substantial industry cost to commissions. I am not aware what it is. Certainly, any industry that relies on commissions as part of its marketing regime does have to pay for the cost of it. But what I am suggesting to you is that this is not the right industry in which commissions should occur because of the very nature of the relationship between the participants.

CHAIR—Even if we legislated to make all forms of kickbacks, rebates and commissions illegal, do you think that would really stamp it out?

Mr Starkins—I think it would stamp out a considerable amount of the practice, because most of the commission paying is by large fund managers who, by and large, are very respectful of their prudential and legal obligations. If you told them to stop paying commissions, then clearly you would make a large inroad into this particular market.

CHAIR—Do you think it would essentially change the nature of the market? I am just trying to work out, if we accepted this, what the implications would be. Would we see a lot of people disappear? Would it become the province of one particular group rather than an opportunity for many? What are the implications of what you are suggesting, apart from the purely ethical one? I am just trying to work out the consequences that might flow from this.

Mr Starkins—The consequences would be an industry that would rely on providing the best possible advice and that would do more to research the best possible advice, rather than rely on commissions to keep them going. They would have to earn their keep each year from their clients. Let us take trailing commissions: for example, a financial adviser receives perhaps 0.5 per cent of the invested amount that they have put with a particular fund manager for a client every year. That is like an annuity income. Generally they say, 'We use this money to review your portfolio and so on.' Now there is no particular incentive to do that because you know the money is coming in all the time. I am not sure how many actually do. The industry would work harder and would provide a better service to the consumer if it did not have this particular kickback regime in operation.

Senator CONROY—Would it help if, instead of the percentage being on assets under management, it was on the earnings of the assets?

Mr Starkins—That is certainly a possible way to go. Many financial planners now do that. Rather than charging commissions or operating in a commission regime, part of their fee for service is that they charge maybe half a per cent of the assets under advisement, which covers that.

Senator CONROY—I am talking about the earnings on the assets—the earning stream, rather than just sitting there and collecting money for holding assets. That is not bad, but what if you were taking a percentage of earnings of the assets? It may have to be a higher percentage, because obviously there is going to be a fall in income of some substantial amount, but would it be fairer, in your view, if it were on the percentage of the earnings stream rather than on assets under management?

Mr Starkins—So you are suggesting a performance based scheme?

Senator CONROY—Yes, God forbid. A bit of productivity in that industry would not go astray.

Mr Starkins—Performance based schemes, from my experience in the wholesale industry, really do not work. What tends to happen is that the provider of the service gets paid significantly more than might otherwise be the case. Performance based schemes do not change the way a product is managed, in my experience. My previous employer, by demand from their clients, offered performance based schemes. So if you outperformed the all ordinaries index by more than two per cent per annum—

Senator CONROY—I probably have not explained myself quite well enough for you. Let us say that I had \$1 million of assets and you are going to manage it for me. I will pay you five per cent of what I earn on the million dollars. That would give you the incentive to want to make sure I am in the best possible earnings stream and I would not just be locked into one particular product because someone has paid you a commission to get me into it. Does that make more sense to you?

Mr Starkins—It does but you might find that—

CHAIR—You might go for the two risky events.

Mr Starkins—If you had perfect foresight that would be a great scheme but unhappily—

Senator CONROY—But there is more incentive after one year when you have done badly in your ANZ one and suddenly you know that Westpac is earning more. You say, ‘I can earn a bit more if I switch this into the Westpac one.’

Mr Starkins—But then you are zagging when you should zig. There is a concept called ‘mean reversion’ in financial markets and you might find yourself selling out of one particular product just as it is about to turn.

CHAIR—So your practice in First Samuel is not to accept commissions but to charge—

Mr Starkins—We charge on the basis of assets under management. A client gives us a sum of money, a certain percentage of those assets, and there are no commissions charged, paid, or received, in our business whatsoever.

Senator CONROY—Would a dollar amount help if these fees were not in terms of percentages? This is particularly relevant to CLERP 6. There is a strong argument about disclosure of a dollar amount rather than a percentage.

Mr Starkins—I do not think that makes any difference. I know we keep coming back to disclosure not solving the problem where you have a customer who may not be as well-informed as they might be.

CHAIR—With assets under management, it is all very well if you pitch your business at the top end and have lots of rich clients. What about the people who sell a life policy for \$200? There would not be very much, would there? It might take a lot more time to draw up the contract than perhaps your fee on the basis of assets under management is worth. I am just trying to work out the ethics of it. If you are trying to sell a lower-priced product to poorer people they are not going to get anything out of it.

Senator CONROY—Try looking at it from the consumer end.

Mr Starkins—In terms of the advice then we would submit that a fee-for-service is the most appropriate way to go, that is, a dollar amount per hour or financial plan or whatever.

CHAIR—I am just having a little bit of trouble with your argument based on assets. If it takes you 5 hours or 50 hours shouldn't it be based on \$100 or \$200 per hour rather than assets under management? I see that as another form of commission because it is a fee based on the amount of money.

Mr Starkins—Senator, I am sorry if I misunderstood your earlier question. When we give financial advice in our business we charge on a fee-for-service basis. If we manage assets for clients in the way a portfolio manager would, that is when we charge on an assets basis. If we give financial advice, be it limited or a full financial plan, we charge a certain amount of dollars per hour for the advice.

CHAIR—Wouldn't it be more ethical if you manage a portfolio—like an accountant—and you do 50 hours at such and such a rate you charge 50 hours times whatever your charging rate is? I am just trying to get a consistency, that is all.

Mr Starkins—The ethics would be if you are a financial adviser giving people advice about investments then certainly we believe that a fee-for-service hourly charge is most appropriate.

CHAIR—Why differ from that?

Mr Starkins—The difference is that if you are discretionary manager of their assets—which our business is—you need to be compensated for the risk that you are taking in that business. The client might very well at some stage seek redress against you which is based on the amount of assets that you have under management. Therefore, from a downside point of view, you need to have a charge which reflects that.

CHAIR—I see a little bit of inconsistency in your argument. I would be happy to accept the first principle that it would be purely consistent to charge everything on the basis on a fee for

service. You are getting back to this other concept which you are deploring. It is almost like a trail commission. It has the implications of the trail commission.

Mr Starkins—The giving of financial advice where you take a commission for making a recommendation is a different area from where you have been appointed to manage a portfolio.

CHAIR—I cannot see any difference in the two. If you want to be pure on one you should be pure on the second.

Mr Starkins—If you are managing a large sum of money on a discretionary basis and if for some reason you find that the client is going to sue you for negligence, the size of that suit is going to depend upon the assets that you manage. Therefore, your charge needs to reflect that.

CHAIR—We come back to the accountants. The accountant does an audit and charges on the basis of the amount of hours worked even though, if he is negligent or there is a problem, they still might sue him. He still probably has to meet an insurance cost of about \$50,000 or \$100,000 a year. He builds that into his costs.

Mr Starkins—If we charged on an hourly basis for the ongoing management of a portfolio, if our business did and if investment management companies did, then you would see a different cost regime.

CHAIR—I am saying that we might have to have a different cost regime. I want consistency.

Mr Starkins—The consistency is in terms of the ethical considerations of the advice that is given. If you are a financial planner and you are giving advice that has to be independent, objective advice—

CHAIR—I accept the first one. I have got no problem with that at all. I am saying that, in terms of the second limb, the managing, why don't you apply the fee for service?

Mr Starkins—In this particular instance we are not concerned with biased advice or paying to get a particular outcome.

CHAIR—That is a possibility. I am concerned about the lack of consistency and how it is going to provide an adequate reward for a life insurance type agent who might sell a product worth \$200 a year to a poor person. If they had to pay an up-front fee on that basis nobody would be interested in taking out a \$200 life policy, would they?

Mr Starkins—What is the value of the advice that is given in that instance? It is the question of the value of the advice that is given in that instance. If the person is acting as an employee and selling a bank's product without giving particular advice, that is one thing. If they are holding themselves out to be a financial adviser—

CHAIR—Let us say they are holding themselves out to be a financial adviser. They work out the profile of the person—family responsibilities, age, earning capacity—they want a certain product and \$200 per annum is the amount they can pay. How are we going to get somebody, if

we adopt your formula, to sell that particular product? That product just will not become available because there will not be anything in it for anybody to go out there and hold themselves out as having the ability to sell that. If it costs them \$400 to get this advice and all they can pay is a \$200 premium for an endowment policy—I am trying to work out the consequences for the industry. Superficially, what you put forward sounds very attractive, but I am trying to work out the practical ramifications for the poorer people in society.

Mr Starkins—The observation that I made in the submission relates to the giving of financial advice; it does not relate to commissions taken by stockbrokers or commissions taken by life insurance agents.

CHAIR—Just a minute. If you go down to the online people, you see they are actually moving away from commissions, so they say, ‘For a \$50 fee we’ll transfer your shares in Coles or BHP or we’ll buy them, et cetera.’ I am just trying to follow the consequences of selling lower priced products if we go down a fee-for-service based line of argument.

Mr Starkins—It would not be a question of whether the product was lower priced or not; it would be a question of whether the product was the best for that particular client or consumer. Part of getting the licence regime is to show that you have the necessary research facilities in place, and if you have then you will be aware of all the products that are there.

CHAIR—Okay, you are aware of all the products that are there, you are very ethical, you do your homework and it costs the client \$400. That is your charge, having evaluated all the criteria that I mentioned earlier. You know the fellow has only \$200 which he can pay in a premium per year, because he has not got much money—he is just starting off in life; he is an apprentice and married. How is the financial planner going to be rewarded on your basis? If he were to say, ‘There is a \$400 fee for a policy,’ people would laugh at him and walk away, and the consumer would not get a service that he requires. That is what I am worried about. We could kill off the market.

Mr Starkins—I think it will enhance the market because you will have a position where that 21-year-old person who is coming in for financial advice will pay up front the \$200, \$400 or whatever it is for a financial plan, will be given financial advice, and will make his investments accordingly.

CHAIR—But what I am saying to you is that that apprentice will not have that up-front capital. I think this is the point that Lyn Ralph makes for a lot of people.

Mr Starkins—With respect, he is paying the up-front capital by the deduction of the premium commission up front. If he is paying four per cent up front, that is where it is going, so instead of investing \$100 he is investing \$96.

CHAIR—Yes, in the first year’s premium he can probably afford that, but he cannot afford the \$400 fee for a \$200 premium.

Mr Starkins—I am sorry, I am not familiar with the concept of premiums in the general regard of the retail financial advice area.

CHAIR—It is a premium for a life insurance policy or something.

Senator CONROY—He is not seeking to apply it in that area.

Mr Starkins—I am not seeking to apply what I have said in the life insurance area. I am not familiar with the regime in the life insurance area.

CHAIR—Yes, but I am saying if we adopt this it really has to be across a spectrum—hasn't it?

Mr Starkins—It is possible, but you should consider the broader application of it.

CHAIR—Thank you very much, Mr Starkins. You have certainly raised a very interesting matter which we will obviously look at with great interest.

Mr Starkins—Thank you.

[1.54 p.m.]

HIBBERD, Mr John William, President, Association of Financial Advisers

MITCHELL, Mr Dugald Scott, Consultant, Association of Financial Advisers

CHAIR—Welcome. The committee accepts as tabled committee documents *Distribution disclosure or commission? Bias and conflict of interest examined* and *Disclosure paper on the current commission disclosure issue in Australia*. Mr Hibberd and Mr Mitchell, we would like you to make an opening comment. As such, we would be interested if you were to comment on the previous witness's presentation.

Mr Hibberd—I have just a few words I have written out that I would like to explain, and I will then comment on what was said by the previous witness. Thank you for giving us time to give our thoughts to your committee on reference (a). I remind committee members that we represent the Association of Financial Advisers. Our association has, for over 54 years, represented those who give financial advice in the financial services area. A majority of our members are self-employed small business people that offer sound and competent financial advice on insurance, superannuation and investment matters to the Australian public. We are part of a financial advice industry of over 14,000 advisers, largely self-employed, with total businesses—that is, renewal commissions—valued at \$5.5 billion and assets under management of over \$550 billion. I myself have been a financial adviser for 30 years. I am also the chairman of a corporate superannuation fund with \$120 million worth of assets under management and 2,300 members, so I am very interested in the work of this committee.

I have two things I want to emphasise before I comment on the previous speaker. On the need for advice: more and more Australians are choosing to build their wealth through the use of managed investments, both in superannuation and non-superannuation. This, of course, is becoming even more important under choice of funds or choice of investments, whichever way you want to go. More and more Australians are seeking financial advice from my association members and many other advisers now operating in the financial services field, as from the quoted figures. Our view is that the public should have the initial choice of whether to seek financial advice or not. As we said in our previous submissions to you, advice is generally delivered through face-to-face contact with advisers, and that is part of the total superannuation picture. We see superannuation, firstly, as information—a brochure is sent out by the superannuation fund; secondly, as education—they run a seminar; and, thirdly, as advice—and in advice there is contact.

I remind the committee members that, under the current code of practice for life insurance based superannuation advice, our members and other people cannot sell superannuation without providing written advice; and for products that come under the securities code—and there are many superannuation products that do—the adviser has to apply the 'know your client' rule and the advice has to fit with the client's current investment profile. So providing sound advice is clearly built in to the regulations.

I have a quick comment on payment for advice. As we all know, free advice is not always good advice. A vast majority of consumers in the financial services area for financial services products are willing to accept advice and accept commissions paid for advice. There are three

methods: firstly, a commission is paid to the adviser by the fund manager, as we well know; secondly, a fee is charged directly by the adviser to the consumer; or thirdly, a point which is of great interest to this committee and to us, is that, through salary advisers employed by many of the large industry funds, advice is provided by salary employees, including the banks. The salaries that these advisers are paid are paid for out of the management charges that the funds charge the members.

Why do consumers and fund members accept commission as a way of paying for advice? Consumers accept it because they do not have to write a cheque—as in the previous discussion. In many cases they are happy for the charges to be made against the investment. This is especially true for a large majority of transactions in the roll-over superannuation area. That is for the consumer. For the fund manager or the product provider, commissions are the most efficient way to market their product, as commission does not have to be paid until the product is written on the books of the company; and then all the distribution costs and the commissions are paid.

In regard to salary advisers of large superannuation funds, we applaud the use of these people if they are properly trained and qualified. However, we object strongly to the fact that these funds are being less than up front in their funding of these advisers in their marketing campaigns that say, 'We do not pay commission.' We think this is less than honest, when their advisers are funded by the same charges that they charge the members and the management charge is taken out of the funds. I will now make a short comment on the previous witness.

For businesses that deal with high net worth individuals, a fee may be the way to go; or if you are entering a new market you may want to charge a fee. However, my members and a large number of financial advisers have to deal with all consumers at all levels of net worth. Those who hold similar views to the previous speaker could deter good financial advice being delivered to many consumers who simply cannot pay the fee. Surely this is not what the government wants, as we try to assist Australians to build their wealth. In conclusion, I have submitted some more information on distribution costs and commissions that may help explain our position.

Senator CONROY—Before we go any further, I need to made a disclosure. I am a former superannuation officer for an industry fund. I thought I should let you know that in advance of the ensuing discussion.

Mr Hibberd—I realise that. Thank you. Do you want to pursue that matter for a minute, Chair?

CHAIR—There is a comment that I should have made to the previous witness. I would really like to commend him on his high ethical principles—that is something we certainly need in this country—and also for drawing the committee's attention to the direction of First Samuel and the consequences of such recognition. It is not easy to bring those before bodies such as ours. I thank you for doing it.

Mr Hibberd, I can appreciate the distinction there but where do we draw the line? At what amount of money would you draw the line if you did go down that path? You say that you can have it for the high wealth individuals, so are we looking at an investment of \$100,000, \$50,000

or \$20,000? This is always the problem: there is going to be a difficulty wherever you draw that line.

Mr Hibberd—As consumers become more aware of financial services and what is happening in financial services, our view is that consumers can make the decision on how they want to pay for their advice. Our problem is that the average amount in superannuation funds in Australia is something like \$5,200—I am not sure that is the correct number, but it is something like that—and that those people leave a company, come for advice on their rollover of \$5,000 or \$6,000 and, under the compliance rules, the adviser now has to do a brief plan and a whole heap of work which needs to be paid for. The adviser needs to be paid for that work and for the advice, and the consumer needs to pay for it. It is up to the consumer to decide how they should do it. Our view is that the government should provide opportunities for the consumer to decide how he wants to work and not put restrictions around it, as per the suggestion of making commissions illegal. If commissions are made illegal, you can only go by fees. That simply will not work; you just will not get people being advised.

CHAIR—You can see the problem that has been brought to our attention. How do you assure a client that they are getting the best possible advice rather than advice that is based on being a tied agent or something like that? That is the real issue, isn't it?

Mr Hibberd—There are two things. One is bias. The current rules say that, if there is any bias, you have got to tell the client. In the current ASIC rules, certainly for securities, there is a long disclosure regime for telling people how we get paid and what we do. The second thing is that, for securities, when we do a financial plan we tell the client on the last page exactly how much we get paid. It is quite clear how much we get paid. The client can decide that that is adequate or not adequate. The current AFGs that we give out before we give advice tell us the method when the plan is done and we give them the exact amount.

CHAIR—If, for example, one bank charges X and the other bank charges X minus 50 per cent, how do we know if they are comparable deals, assuming they both have the same thing to offer?

Mr Hibberd—Do you mean two recommendations and one has a bigger commission than the other?

CHAIR—Yes.

Mr Hibberd—If the consumer wants to go to two advisers, the advisers will say, 'This is the commission for the advice I am selling, this is the level of advice and this is how much I get paid for this level of advice,' and the consumer can decide. If it is disclosed, the consumer can certainly make a decision.

CHAIR—You are not obliged to disclose the level of commission based on each aspect of what may be your recommendation?

Mr Hibberd—Yes, we are, apart from risk—

CHAIR—The menu rather than the recommendation.

Mr Hibberd—The current view is that, apart from life insurance and risk business where we are not required to disclose, most other commissions are now disclosed to the advisers. It is a matter of their customer advice record or their financial plan, so they know.

Senator CONROY—I start looking at these issues from the point of view of the consumer getting the maximum return—that is, maximising the consumer return. You would be familiar with the concept of opportunity cost?

Mr Hibberd—Yes.

Senator CONROY—Mr Starkins's argument is that an adviser that is tied, whether it is via commission or being directly employed, as well as the other incentives basis, will not tell you the opportunity cost. You heard me talking before when I used the example that I was an ANZ adviser of a Westpac product. How do you respond to the criticism that—albeit disclosing that I get X dollars or one per cent, or whatever the per cent is—if they take this product or this product they are both from ANZ, whereas they could be getting a cheaper product or a better returning product somewhere else. How do you respond to that?

Mr Hibberd—Part of the question is: what is sound advice to the consumer? How much information do we have to give the consumer so they can make a choice on where they want to go with their money? That is part of your question, isn't it? Are we supplying the consumer with enough information to make a decision?

Senator CONROY—No. Your definition of 'sound' and mine may not be the same, which is where the problem comes in. I am talking about opportunity cost. The opportunity cost of taking your advice is that I might get a six per cent return and it may cost me \$1,000, whereas if you were advising about a product with a rival I may be getting seven per cent of return and \$1,000.

Mr Hibberd—Two things about that. If you take return as the only test, which you would not—

Senator CONROY—No. I am saying there are a couple of 'take' tests.

Mr Hibberd—If you take return, the adviser has to justify the advice he is giving. That is in the Corporations Law, so if he ends up in court he can justify it. The classic case today is what we call a multifund product where ANZ or AXA badge products have 20 managers. You have seen them. Most advisers put out in front of the client the returns over the last five years on a sheet and say, 'Here are the returns for these products over the last five years, and here are the recommended five managers within that fund I am recommending, and here is why.' For many advisers today that recommendation is based on research supplied by the dealer group.

So, if you are a balanced investor, the dealer group will say, 'In that multifund, here are the five managers you should recommend at this stage of the investment cycle, and the research companies tell us every month why that should be done.' So the backup is the advice is based on information supplied by his dealer. If that information is wrong, it is the dealer's problem and not the adviser's problem. Secondly, if you put in front of the consumer the returns and the background to the management of those companies, which is just as important, you have, as far as we can see, given the consumer enough information to decide on the opportunity cost. I must

say though that it is not all to do with returns. You would know from your industry superannuation fund experience, if we took the highest returns for the last year and invested in that, by the time we got to 10 years we would have less return than if we had done an ordinary balance fund. So there are many sections to the advice, not just the returns.

Senator CONROY—I agree with that. Just a slight diversion: do you have a position on dollar versus percentage?

Mr Hibberd—In terms of commission disclosure?

Senator CONROY—Yes.

Mr Hibberd—The current disclosure is percentage and then dollars. That is the current thing for security.

Senator CONROY—There is resistance to CLERP 6, as you know. There is resistance to dollar disclosure from some sections of the industry.

Mr Hibberd—If you want to discuss CLERP, that is a whole other issue.

Senator CONROY—No. It's another dollar question.

Mr Hibberd—Our view is that the consumer should be informed. There is a view around that, if it is a percentage, the consumer cannot work it out; most consumers can certainly work it out. If we are talking about \$5,000 or \$6,000 for advice for putting a plan together, they pay attention, I have to say. In some respects the consumer needs to pay attention to the work being done. We are forever trying to get the consumer to buy into this discussion on sound financial advice. It is a major problem.

Senator CONROY—Can I ask for your response to the following. Mr Starkins argued that his interpretation of fiduciary duty is that you should be solely advising on behalf of the best interests of the client. Do you agree with his interpretation?

Mr Hibberd—No.

Senator CONROY—Do you agree that somebody who is receiving payment, in whatever form, from a third party to recommend a product can give advice based purely on the best interests of the client?

Mr Hibberd—There are two things. Firstly, the restriction of fiduciary duty is limited. He has taken a limited thing. Secondly, commissions are a structure in the business community anyway. There are commissions on the sale of properties, et cetera. It is fairly standard stuff, and so they have to stretch that and say that all these people have a fiduciary duty. The difference is that you are selling a financial services product and that it has a long-term effect on the consumer. Our view is that financial advice needs to be delivered and paid for. I come back to my same story that you just cannot get everyone to pay fees. And, as the senator said, you will not have people doing the job. Right now, as we go to superannuation choice, we have 17 million superannuation accounts in this country and we have eight million workers. As we

move more to choice, they all need advice. We are self-employed advisers. If people want to give advice and wear charity, that is fine. But we reckon sound businesses that provide good advice—and they are sound businesses because they are getting paid for their work—are the way to build a strong financial services economy.

Senator CONROY—Thanks for the promo. What I asked you was whether or not you agreed with Mr Starkins that somebody who was tied to a third party could give independent advice that was solely in the best interests of the individual—the client customer—even if they had a financial relationship of whatever form with another party.

Mr Hibberd—Under the current dealer regime under the Corporations Law, every proper authority holder is tied to a dealer, so he is tied straightaway. The dealer decides what products to put into his mix and what products his advisers can recommend. It is the dealer's position to say what products and then it is the adviser's position to decide what products to recommend. I disagree that they are biased because they are getting paid by commission. They are simply doing a job as per the way that certainly CLERP and the current securities regime say it should be done. You know the client rule; under the ASIC rules that is how we are doing the job.

Senator CONROY—So if they were not getting paid any commissions by anybody you believe they would give exactly the same advice?

Mr Hibberd—Absolutely, because you are getting paid to deliver advice. You are not getting paid on a volume bonus or on some sort of additional thing because you are doing a \$400,000 deal. What has happened in the marketplace now is that for a \$400,000 deal the up-front fees are now negotiated. They are not four per cent but they are negotiated at—I don't know, it depends—1.5 per cent or two per cent. For most of these financial services products the up-front fees and the commissions—let us take about half a per cent off—are somewhere between one per cent and five per cent. I think the standard one is probably running at 2.5 per cent. I think we are getting about 2.5.

CHAIR—With respect to the previous person, he would retort by saying, 'The fault really lies in CLERP 6.' You are relying on CLERP 6. What the previous witness was saying is that CLERP 6 is based on a bad premise.

Mr Hibberd—It is based on the Corporations Law.

CHAIR—Yes, I know.

Mr Hibberd—If that is his interpretation of the law—

CHAIR—That is how I have seen it.

Mr Hibberd—We do not agree with that premise.

Senator CONROY—My final question is about free and informed consent. He argued very strongly that a lot of people—not everybody—would not be genuinely free and informed by the information they currently receive. Would you agree or disagree with that proposition?

Mr Hibberd—I think they are informed. I think the consumer needs to begin to pay attention to the information he is given. I do not agree with the proposition of informed consent. I just know that we struggle to have consumers actually go through the information we are now providing them, and we keep improving it all the time. But it is the consumer's money and he should accept or not accept the advice we are giving and take some responsibility for the decision.

Senator CONROY—I have had some experience of this, unfortunately. I was 21. Mum and dad invited their agent in. I had just got my first job, and my parents said, 'You've got to provide for your future.' He came in and showed me some graphs and told me how well they had performed, and so on, and asked me what I wanted, and he sold me some product. Would you say I had free and informed consent when I signed the contract with him—straight out of university and had just literally started my first job? Within the first couple of months mum and dad said, 'You've got to sit down and think about these things,' at 21.

Mr Hibberd—There are two questions here: one is that straight out of uni the adviser was giving information—

Senator CONROY—I had an economics degree, I should say—nothing to do with the real world; it was an ANU economics degree.

Senator ALLISON—Are you sure you want to go on with this? This is embarrassing.

Senator CONROY—It is a very embarrassing situation. I recently closed them—15 years later.

Mr Hibberd—If the information was provided in the right framework an intelligent university student should have been able to read that and pay attention to it. I come back to the point that the consumer has got to take some responsibility for it. My view would have been: here is the information, let us have a discussion and let us make a decision about it. Under the current rules they have to sign off the plan. If they do not read it, that is their problem. What has happened—and I am sure this did not happen with you—is they are in a hurry and they say to the adviser, 'Whatever you want is fine,' and off they go. We say, 'Hey, stop and pay attention.' We struggle with that all of the time.

Senator CONROY—I was paying attention.

Mr Hibberd—I am sure you were.

Senator CONROY—Feel free to jump in, Mr Mitchell.

Mr Mitchell—Can I ask you a question about that?

Senator CONROY—Absolutely. My embarrassment cannot get much worse, so keep going.

Mr Mitchell—Do you think that information at school and so on would have helped in making that first decision? What has happened to you is that you have considered you have made a bad decision and therefore all the decisions from then on are affected by that decision.

Senator CONROY—There were no more decisions to be made. It was an ongoing policy to mature at 55.

Mr Mitchell—Yes, I think there have been, because you have not done anything.

Senator CONROY—I accept that waiting 16 years to see my \$16,000 mature may have been a poor ongoing financial situation. My circumstance has changed, which is what made me go and review it. The kind of product I was sold is not sold anymore, which is probably what left me feeling fairly suspicious that perhaps I had not been sold quite the most appropriate product.

Mr Hibberd—At the time it was probably the only type.

Senator CONROY—That is a fair comment. The types of products that were available back in 1984 are markedly different to those available now.

Mr Hibberd—Absolutely.

Senator CONROY—That is a fair defence.

Mr Hibberd—The problem is that now there are so many. Our job is to break it down so the consumer can understand it.

Senator CONROY—On the basis of free and informed consent, I am a just a bit suss that I was perhaps not meeting the ideal that Mr Starkins defined in his definition of ‘free and informed consent’.

Mr Hibberd—It is not an ideal world out there in consumer land.

CHAIR—The other problem, Senator Conroy, is perhaps the ANU did not provide you tuition in the—

Senator CONROY—ANU economics has got very little to do with the real world. I am the first to put that up.

CHAIR—Senator Conroy made a disclosure a few moments ago. Perhaps I should do the same. Although I do not get remunerated by virtue of commission, et cetera, I am a director of a superannuation fund that provides opportunities for commission under certain circumstances. As we are discussing this, I perhaps should disclose that.

Senator CONROY—I just wanted to give Mr Hibberd a warning before he bagged industry super funds any more.

Mr Hibberd—I already knew that. I said that because of my concern—I am involved in it, as you gentlemen are; that is why—not to dig that information out.

Senator ALLISON—I have nothing to disclose—except to ask about a couple of questions that you pose. You say that, if we have disclosure for commissions, ought we not have a disclosure along the lines that a bank adviser is paid a salary—which, I think, points to a problem with where you go in terms of disclosure? In your experience, is there enormous profit taking through commissions as opposed to the promotion of bank advisers on salaries? Is it your experience that those doing commission selling are doing very nicely? Is it a very competitive field out there? What is the trend? Are we getting away from commission selling and more towards other forms of advice?

Mr Hibberd—The first thing is that my members—the bank people—are in the business of providing advice and, being in business, we like to make some money out of this area. What is ‘super profits’ and what is ‘profiting’ from it is a matter of subjective judgment. Basically, the entry fees are somewhere between two and five per cent. Out of the entry fees for most of these investment products we get paid a commission of one, two or three per cent. The practice is that the commissions are going down. There is a move towards fees but, according to the financial planners, less than 20 per cent of their members charge fees significantly. Mr Starkins was right: it is a high net worth area where people are happy to pay fees. The financial advice business is very strong and now becoming very competitive because, as you well know, superannuation funds are growing at 25 per cent a year. Businesses are competing to get into that market. There are a large number of new players coming into the market. The consumer should look at what is being given to them as advice and decide whether it is fair or equitable for them.

What we are finding with small rollover funds is that it takes just as much time to do, say, a \$20,000 fund as it does to do a \$300,000 fund because of the compliance and the regulations. So advisers are tossing up how they get paid for that in terms of the hours involved in that exercise and the experience. Over the last five years, financial advisers are much more educated than they were—with CFPs and degrees. All of them are trained to a certain level now, and our view is that the consumer should pay for that advice. It is like getting an accountant or any sort of expert, and the industry is fast becoming very professional.

Senator ALLISON—I am not sure you answered my question.

Mr Hibberd—I am sorry; do you want to ask it again?

Senator ALLISON—Commission selling is fearful to many of us. That fear is about people losing more than they otherwise would if they were getting straightforward advice, say, from someone on a salary—that there is a higher flow of money through commissions than there would be in any other way. That would suggest that those who are successful in selling with commissions are doing very well. Are these the wealthy?

Mr Mitchell—Commission selling is a business, and the business prospers according not to the commissions but to whether the person is a good prospect or not, whether he can find the clients. That is how people make a lot of money out of commission sales. The commission has to be reasonable for a person to start and to work—he is not going to do it for nothing because he has to pay the bills. So it is a business matter. To answer your question as to whether there is

a lot of money being made out there, there is a lot of money being made by the top people, but the average person would be on about the average salary that most people get in Australia. If that is the case, then the situation insofar as commissions is concerned is that people are not being, to use the expression, ripped off.

Mr Hibberd—Let me explain. We employ 14 people to run our business—three partners and myself to run our practice with 10,000 clients. So it is a business. We are being paid by commissions and trails to run that business to provide advice. The question, I think, is: if people are doing very well at business, does that mean they are ripping people off? I suppose—as small business people—I would say no. They are successful; they are very good; they are very efficient. The salary adviser one is interesting because that salary adviser at the bank still has to be paid, and he is being paid out of the fees and charges that are being charged to the client for the recommendations he has made. That was my point in my little talk at the start. The salary advisers are still being paid. Mr Starkins is right in some respects with regard to how some of those salary advisers have done their job. The advice job is the same. If I am a bank employee, I am still delivering the same advice; I am just being remunerated differently by a salary as opposed to a commission.

Senator ALLISON—But they do not have the same incentive to turn over as many clients, do they?

Mr Hibberd—Yes, they do.

Senator ALLISON—What are the incentives then?

Mr Hibberd—An example would be one of the largest institutions in this country being taken over by a merger of 150 salary advisers. They are salary advisers. I can tell you that they get the same trips to Vienna as the other places. They are on incentives. We have looked at contracts for people who are salary advisers and they get bonuses on top of their salary if they produce a certain amount of business. So if the question is that they are biased because they are making money out of it, they still have incentives built into it, even though they are salary advisers. That is standard practice, in fact.

Mr Mitchell—There is another point about that. My daughter is a manager with NRMA in this area. The incentive there is not getting the sack. If you do not sell a certain number of policies or if you do not get a certain income, you go. That is just as much a bias, I think, as commission.

Senator HOGG—Could I just follow up? Is all of this clearly laid out so the average person can see exactly what is going on? This is the real problem that you suffer from.

Mr Hibberd—Absolutely.

Senator HOGG—There is a shroud of mystery, an air of mystery, surrounding the whole thing. Let me say that I am no more or less sceptical than everyone else. My scepticism is a very healthy scepticism based, like Senator Conroy's, on contacts that I have had with the industry over a period of time, personal experiences, and the experiences of others that I know. It seems to me that, unless there is transparency and accountability, you will always live under the

shroud of scepticism that is out there in the public. How do you overcome that and how do you convince people such as ourselves that there should not be more transparency in the whole process?

Mr Mitchell—I think that you need a common and equal disclosure regime. If Mr Bernie Fraser says, in his talk on television, that there are no commissions, or if the bank officer who is dealing with this area does not have to disclose anything, there is a bias; it is it is not a level playing field.

Senator HOGG—That is right. What about the trip to Vienna and all of these other things? They are all part of the inducement.

Mr Mitchell—I think the way you deal with that is, if you are selling a product, the government could say very clearly, ‘This is the way you calculate the total distribution cost of this product.’ If they did that, if it was calculated in the same way—if it is not set out how that is calculated, people will cheat—and if you had a total distribution cost and everybody understood that, which is almost impossible to do but that is the way to do it, you would get transparency because you would know where the costs were going and what the costs were.

Senator HOGG—One of the increasing demands that we face today as politicians, regardless of what political party we are in, is the call in the media by the public for greater transparency and greater accountability. Where that is not seen to be happening, the government of the day, the political party or the individual who is transgressing becomes the subject of great criticism out there.

There, undoubtedly, would be financial advisers who would be very honourable in their approach, in their charges and so on. Also, though, there are those at the other end of the marketplace, who are the people who invariably those who have the least capacity come into contact with, and their views are tainted by running into those people. When I say ‘the least capacity,’ it could be the least understanding of the marketplace, the least understanding education wise, the least money at their disposal to avail themselves of the best. How do you then bring in the transparency and accountability criteria that are necessary in this area?

Mr Hibberd—We agree with accountability and transparency. We have no problem about that. In fact, we have said that in our submissions. There are two things that we look at. There is total distributions costs, not just commission. The transparency is the fund managers and the life companies who put out products, not just the commission. We agree that total transparency should be put forward. The problem we have—as you highlighted, Senator—is how we display that, how it is communicated to the client. Currently under the CLERP regime there is some discussion about how that should be communicated. ASIC has ruled how it should be communicated, and we have worked with ASIC and with the CLERP people on improving that. That is one thing.

The next thing is how the client understands it and what the level of advice is. Like all industries we have high level, highly trained, highly ethical people and we have other people who are still coming through that regime. However, the good news is the current rules, as we go towards CLERP, say you have got to have some educational qualifications, and the ASIC people put out policy statement 146, which says you have got to prove competence by the end

of December next year to be in this industry, with ‘competence’ being education, skills, ethics and attitude. We commend them for doing that. As far as we can see, all we can do is try to encourage advisers to be competent, encourage the dealer principals to only put competent agents on and ask ASIC to ban anybody—which they do regularly—who is not fulfilling those judgments. Our association has been involved for 45 years in trying to educate and bring the levels of skills up for advisers.

CHAIR—We might be losing a quorum. Is it the wish of the committee that we form a subcommittee for the purpose of continuing the hearing and to take evidence tomorrow? There being no objection, it is so ordered.

Senator HOGG—You listed a number of criteria. Does one of those criteria—and I did not hear it if it is there—depend on proven positive results for the client over a period of time, because not everyone can judge that?

Mr Hibberd—We are selling a managed fund. We are the intermediaries. So there is a fund provider that is selling a managed fund—a superannuation product—and we are advising on that, and we are saying, ‘We think that for you, for where you are in life and so on, these are the funds you should do, and here are the returns.’ We cannot take responsibility for the returns of the fund managers. What we are trying to do is say, ‘The way we go about advising you is this, and this is what we are advising you to do.’ Then if the client accepts that, the returns on the products—if that is the test—are out of the hands of the adviser.

Senator HOGG—Yes, but the adviser must wear some of the odium if there is odium attached.

Mr Hibberd—The ultimate test of whether the adviser has done his job properly is whether the adviser has used the processes that the dealer says he should—which was in my previous discussion on using the research companies that provide research on these matters—and says, ‘These are the fund managers inside that multifund that a balanced investor should invest in at this stage of the business cycle.’

CHAIR—Thank you very much, Mr Hibberd and Mr Mitchell. That concludes the committee’s proceedings. On behalf of the committee I thank all witnesses who have given evidence. Commissions and transparency has certainly been a contentious and difficult issue. We are obviously going to need the wisdom of Solomon to try to work this one out. Thank you very much for appearing before the committee. There were other questions, but we will leave those for a further occasion.

Mr Hibberd—If you would like to send them to us in writing, we would be happy to answer them.

CHAIR—Thank you.

Proceedings suspended from 2.35 p.m. to 3.04 p.m.

Evidence was then taken in camera—

Committee adjourned at 5.27 p.m.