GOVERNMENT RESPONSE TO THE JOINT STATUTORY COMMITTEE ON CORPORATIONS AND SECURITIES REPORT ON THE DRAFT FINANCIAL SERVICES REFORM BILL

Introduction

The Minister for Financial Services & Regulation, the Hon Joe Hockey MP, released the exposure draft Financial Services Reform Bill on 11 February 2000 for 3 months' public comment. On 8 March 2000, the Parliamentary Joint Statutory Committee on Corporations and Securities resolved to hold an inquiry into the draft Bill. The Committee tabled its report on 14 August 2000. In addition to 8 recommendations on the Bill made by the Committee, the report contains a minority report by Labor members.

The Government's response to the Committee's recommendations is as follows.

Committee recommendation: Final Bill should be passed.

Response: The Government welcomes this recommendation, and will seek to finalise the drafting of the legislation for early Parliamentary consideration as soon as practicable.

Committee recommendation: Amendment to address adverse effects of the draft Bill on the delivery of financial services in rural and regional Australia. In particular, the Committee recommended that the draft Bill be amended to remove deposit products offered by authorised deposit taking institutions from the definition of financial product.

Response: The Government recognises the need for the Bill's requirements to apply flexibly to basic deposit products and to ensure regulatory proportionality. Accordingly, the Government will amend the draft Bill so that deposit products offered by authorised deposit-taking institutions that are for a term of 2 years or less with no management or break fees will not be subject to the financial services guide requirements or requirements to provide statements of advice. This will ensure that the Bill's requirements apply flexibly to basic deposit products recognising that they are generally well understood by retail consumers and that consumers can get their money back on demand.

Amendments are also proposed to the draft Bill's definitions of financial product advice and dealing to ensure the requirements for licensing and authorisation are more tightly focussed. This will ensure that activities commonly engaged in by tellers such as the accepting of moneys for deposit or the giving out of moneys from deposit accounts will not be caught by the FSR regime.

The Committee's report highlights some concerns about the Bill's competency requirements for representatives, such as tellers or employees of third party agents. These concerns are unfounded and do not support arguments for the wholesale removal of deposits and means of payment from the draft Bill. The intention with these requirements is not to force every representative to be competent to provide full financial planning services. Rather, representatives will only have to be competent to provide the services they actually provide – no more and no less. The Government does not expect industry participants who are adequately trained and competent to provide the services they now provide to have to undertake significant extra training to meet the draft Bill's competency requirements.

The Government believes that the final form of the legislation will not hinder the operation of Rural Transaction Centres or distribution of deposit products through third-party agents such as newsagents or pharmacists in country Australia. The Government is committed to ensuring that all Australian consumers of financial products receive the same level of protection, irrespective of where they live or how they access those products. Hence, the draft Bill's requirements will ensure that consumers of financial services in the bush will get the same protections as consumers in cities. In particular, they will require deposit-taking institutions to ensure that their staff and agents are competent to provide the services they offer consumers, whether those consumers live in rural, regional or city Australia.

Committee recommendation: Amendment to address the information economy and e – commerce. In particular, the Committee recommended that the draft Bill be amended to exclude information provided in certain circumstances from the definition of financial product advice.

Response: The Government welcomes the support for the information economy and e-commerce. One of the underlying objectives of the draft Bill is to ensure that the regulatory regime is media-neutral and encourages innovation in the design, distribution and use of financial services and products.

The Government does not believe it needs to amend the definition of financial product advice in the way recommended by the Committee to address the concerns raised in evidence to the Committee on the information economy and e-commerce. Rather, the Government is amending the draft Bill to clarify the application of its requirements in a range of e-commerce situations. For example, the Bill will clarify that a person who merely provides a communication service through which a consumer makes a non-cash payment is not the provider of the non-cash payment facility.

Committee recommendation: Amendments to address issues concerning Australia as an international financial centre raised by Australian Stock Exchange Limited (the ASX).

Response: The Government is keen to enhance Australia's role as an international financial centre. The Government also agrees that the Australian market needs to be able to respond quickly to change, domestic and international, in order to continue to remain relevant. However, the Government is not convinced that the examples cited in evidence to the Committee by the ASX will have the effect of undermining the future of Australia's markets. In particular —

- the object of provisions relating to the regulation of foreign-based markets operating in Australia is facilitative - to ensure that those markets which are subject to an appropriate regulatory regime overseas are not, in addition, subject to the full rigours of the Australian regulatory regime. The intention is that the regulation of such markets in Australia and overseas, when taken together, be equivalent to the regulation of a comparable market which is licensed only in Australia;

- the purpose of requiring that Australian incorporated bodies which operate a market or clearing and settlement overseas be licensed in Australia is to ensure that Australia does not lend its name to doubtful operators who may mislead overseas investors by implying that, since they are incorporated in Australia, they are

regulated in Australia. Such a situation would adversely affect Australia's reputation as an international financial centre;

- the Government remains committed to providing regulation of financial markets through a combination of self-regulation, and regulation by the Minister and ASIC. A wide power of delegation to the regulator, ASIC, is necessary to ensure flexibility in the operation of the new legislation into the future, but it is expected that the Minister will continue to be the decision-maker in relation to the major markets.

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

On 10 October 2000, the Minister for Financial Services and Regulation, the Hon Joe Hockey MP, announced that the Government had decided that the shareholder limitation on the ASX would be changed to 15%, with the possibility of a larger shareholding being permitted if the acquisition is in the national interest. The same limitations would apply to other financial markets and clearing and settlement facilities which are of national economic significance. These changes are to be included in the draft Bill and will complement the 'fit and proper' person test which will apply to controllers and senior managers of Australian markets and clearing and settlement facilities.

Committee recommendation: Amendment to address the impact on small business. In particular, the Committee recommended that the draft Bill be amended to remove the requirement for disclosure in the Statement of Advice of quantum of commission on risk insurance products.

Response: The Government does not accept the Committee's recommendation. The draft Bill provides that, where personal advice is given to a client in relation to any financial product, the financial service provider must provide the client with a written copy of the advice including details of —

- any benefit or advantage the financial service provider may receive in connection with the advice or the sale of a financial product, and

- any other pecuniary or other benefits (including soft dollar arrangements) which may reasonably be expected to influence the financial service provider in giving the advice.

The purpose of disclosure at this stage is to help the consumer identify any potential influences on the advice given or any potential conflicts of interest which the adviser may have in recommending a specific product. It is not to indicate the extent to which any return the consumer may receive on the product is reduced by such commissions. Nor is it to identify the distribution costs associated with the product.

In requiring the disclosure of benefit or advantage at this stage, the draft Bill will ensure that consumers are provided with information that will help them make an informed choice about whether to purchase a product or not. The disclosed information helps the consumer evaluate any possible influences on the adviser in recommending a particular

product. For example, if an insurance agent received commission, bonuses or soft dollar remunerations, this would need to be disclosed in the same way as a salaried bank employee disclosed the receipt of a performance bonus based on the number of products sold .

For a consumer to assess possible conflicts an adviser may have in recommending a product they need to know the quantum. Conflicts of interest do not only occur where commission affects the return to the client. For example, an adviser may have a conflict of interest where they receive a 25% commission on a risk product even though the amount of commission does not affect the payment to the consumer if or when the event which is insured against occurs.

Committee recommendation: Amendment to address co-regulation and the position of professional bodies. In particular, the Committee recommended that the draft Bill be amended so that it does 'not affect anyone whose involvement in financial services is incidental to their main activity'.

Response: The Government does not accept the Committee's recommendation. From the consumer's perspective, the loss they might suffer from poor financial advice given by, for example, an accountant who provided that advice incidentally to accounting services is no less serious than the loss they would suffer if the poor advice had been given by someone whose main activity is the provision of financial advice, for example a financial planner.

The draft Bill requires that anyone who provides defined financial services be competent to do so and provides the same minimum consumer protections. This requirement applies irrespective of whether the service provider calls themselves insurance agent, financial planner, accountant or lawyer.

Generally speaking, providers of financial advice will require an Australian Financial Services Licence. The draft Bill provides an alternative mechanism for those wishing to provide financial advice in the form of the declared professional body mechanism.

In light of submissions on the draft Bill, amendments have been made to the definitions of financial product advice and dealing to ensure that it is clear what activities will attract the operation of the Bill.

Committee recommendation: Provide proper recognition of corporate structures and the retail/wholesale client definition.

Response: As a result of the consultation process on the draft Bill, amendments have been made to the Bill to accommodate conglomerate structures where staff are employed by a single corporate entity within the group.

In relation to the potential capital gains tax consequences for existing industry participants in moving to the new licensing regime contained in the draft Bill, consultations have been occurring on this issue since February 2000. The Government will consider whether any legislation is necessary to deal with the tax consequences as a result of the FSR Bill.

In relation to the retail/wholesale client definition, as a result of the submissions received during the consultation process, the Government has amended this definition to align it more closely with the current definition in the Corporations Law and to clarify that Financial Services Licensees and prudentially regulated bodies are wholesale clients.

Committee recommendation: Amendment to start date of the Bill.

Response: The Government notes the Committee's recommendation that consideration be given to the timing of the FSR regime to allow industry sufficient time to comply with the new regime. The Government is keen to finalise, introduce and secure passage of the draft Bill as soon as possible. It will take account of the Committee's views, and those of the regulator and interested industry stakeholders, when determining when to commence the legislation. The Government also notes that it proposes to include transitional provisions in the draft Bill under which existing industry participants will be able to comply with some current requirements rather than the new law for a period of up to 2 years.