

LABOR MEMBERS MINORITY REPORT

ON THE FINANCIAL SERVICES REFORM BILL

Summary

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

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

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

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

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

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

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

¹ Committee Hansard, pg. 266

² Ibid.

General Comments

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

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

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

Other examples of the flexibility within the Bill include:

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

³ Committee Hansard, pg. 266

⁴ Committee Hansard, pg. 268

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

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

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

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

Specific Comments

Amendments already introduced

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

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

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

Deposit Products

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

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

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

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

Disclosure of Commission and other issues which affect small business

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

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

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

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

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

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

Insurance

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

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

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

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

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

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

Declared Professional Bodies

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

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

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

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

Consumer Issues

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

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

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

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

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

⁵ Committee Hansard, pg. 244

⁶ Committee Hansard, pg. 50

⁷ Committee Hansard, pg. 122

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

Superannuation

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

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

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

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

