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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Reference: Financial Services Reform Bill

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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Monday, 17 July 2000

Members: Senator Chapman *(Chair)*, Senators Conroy, Cooney, Gibson and Murray and Ms Bishop, Mr Cameron, Mr Rudd, Mr Sercombe and Dr Southcott

Senators and members in attendance: Senators Chapman, Cooney and Gibson and Dr Southcott

Terms of reference for the inquiry:

Financial Services Reform Bill

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WITNESSES

Committee met at 10.06 a.m.

SMITH, Ms Ruth Viner, Specialist, Financial Markets Division, Department of the Treasury

WILKINSON, Ms Vicki, Manager, Financial Services Project Unit, Department of the Treasury

WILLCOCK, Mr Michael, General Manager, Financial Markets Division, Department of the Treasury

VROOMBOUT, Ms Susan, Specialist Adviser, Financial Services Project Unit, Department of the Treasury

CHAIR—I declare open this public hearing of the Joint Statutory Committee on Corporations and Securities and welcome the witnesses who will be appearing before the committee. The purpose of the hearings is to take evidence on the committee's inquiry into the draft Financial Services Reform Bill. This is the first hearing of this inquiry and the committee will be holding further public hearings in Sydney on Monday, 24 July and in Melbourne on Tuesday, 25 July. The committee has received and published 61 written submissions, which it will consider, along with the evidence it receives during the public hearings, in preparing its report. The committee prefers to conduct its hearings in public. However, if there are any matters that a witness wishes to discuss with the committee in camera, we will consider such a request. May I also remind witnesses that the giving of false or misleading evidence may constitute a contempt of the parliament.

Would you care to make an opening presentation or statement, and then we might move to questions.

Mr Willcock—Thank you very much to the committee for inviting us to be here today. I would like to make some introductory comments on the context in which the bill has been developed and its current status, as I think that might be of some assistance to the committee's inquiry. Firstly, I will talk about why the government is undertaking the bill and what it wants to achieve with it. The background to the bill really arises from the Wallis inquiry, which identified a number of drivers of change in the financial sector, including the explosion of products that are now available to retail consumers, the blurring of boundaries between different institutions, particularly in the context of the emerging financial sector conglomerates that are typical now in the financial sector, increased competition in the provision of products and the varied and piecemeal regulation of the different products that are available.

In response to those drivers of change, the Wallis inquiry made a number of recommendations, most of which have been implemented by the government already. The first stage of that implementation program took place on 1 July 1998 with the creation of APRA and ASIC. The second stage, which was effective from 1 July 1999, saw the transfer from the states to the Commonwealth of regulatory responsibility for a range of state based financial institutions such as building societies, credit unions and friendly societies. The government therefore sees the Financial Services Reform Bill as stage 3 of the Wallis program of reform.

In particular, the bill will ensure that the full efficiency benefits of the Wallis vision of reform to the financial system are delivered as well as the considerable benefits to consumers which will arise from having products regulated in a consistent way. The bill has been developed with the following objectives in mind: to remove unnecessary regulatory distinctions between financial products—these distinctions have led to regulatory arbitrage in the financial services industry and have added to compliance costs—to increase competition through regulatory neutrality, to facilitate product innovation and to provide a consistent level of protection for retail investors of financial products.

The fundamental way that the bill seeks to achieve these objectives is to break down the existing so-called silo regulation of different products. That is, the government is aiming to harmonise existing rules leading to an integrated framework for all financial products. The financial products that are covered by the bill include interests in managed investment schemes, life insurance products, general insurance products, superannuation, deposit taking and derivatives and foreign exchange.

Turning to the status of the bill, I think it would be useful if I set out briefly the consultative process that has been used to develop the bill to this stage. There was an initial position paper released by the government in December 1997 for public comment. That was followed by a consultation paper released in March 1999 which sought reaction to a more detailed picture of the government's proposals in this area. The third stage of consultation began on 11 February of this year with the release of the exposure draft bill and an associated commentary for public comment. That was for a three month exposure period. We have received over 100 submissions in response to the invitation to comment. Notwithstanding that the exposure period ended on I think 12 May, it is fair to say that quite a few submissions have come in since that date. Indeed, we still expect to receive some.

To facilitate the preparation of the submissions and to allow stakeholders to get a better idea of each other's perceptions and interests in this area, we organised three roundtables in April, with 30 stakeholder representatives. Those roundtables, in particular, looked at the bill's proposals in relation to the regulation of financial markets, the product disclosure requirements contained in the bill and the licensing regime for financial service intermediaries. We have also had quite a number of meetings with interested parties since the release of the bill, with people wishing to approach us to get further clarification of the provisions in the legislation.

On 27 June the Minister for Financial Services and Regulation announced the deferral of the planned introduction of the bill which had previously been anticipated to take place in the winter sittings. He did so because of the uncertainty arising from the High Court's decision in the Hughes case. The government is seeking to overcome that uncertainty in cooperation with the states by seeking a referral of power to the Commonwealth to cover the subject matter of the Corporations Law and the subject matter that this Financial Services Reform Bill also deals with. The minister restated in that announcement the government's commitment to enacting the bill by 1 January 2001.

In light of the deferral of the planned introduction of the bill, we are now working to finalise the legislation. This involves reviewing the bill to ensure that it is consistent with the Corporations Law as Commonwealth legislation enacted under power referred by the states. We

are also taking the opportunity to finetune the bill's provisions prior to the planned introduction in the spring sittings.

I would like to conclude these comments by saying that generally speaking the responses that we received in the 100 submissions and in the course of the roundtable consultations that we conducted have been positive. Most of the comments that we have received relate to technical finetuning and drafting suggestions. In saying that I do not want to suggest, however, that the comments have not covered fairly significant aspects of the bill because finetuning or definitional comments as to the drafting of the provisions nonetheless can have a fairly substantial impact in terms of whether or not a particular activity or circumstance is brought within the regulated framework of the bill.

I want to stress that, at this hearing, I cannot pre-empt the minister by announcing any changes to the bill or the government's policy intention resulting from the consultation process that has been engaged in to date. I would need to refer any questions along those lines to the minister for him to respond to. However, my colleagues here are more than happy to talk about the competing policy interests which might be involved in considering particular issues that have been raised in the course of the consultation program. I understand from the number of submissions that you have already received that you might already have had quite a few issues raised by stakeholders directly. Some of those submissions may well be quite familiar to us, as I imagine that some of them are along similar lines to the submissions that we have also received. As I mentioned, we are more than happy to take any questions that you have on the issues raised.

CHAIR—I will ask a couple of questions to start with. You raised the issue of the deferral of the introduction of the bill. You said that there were two factors there. The first one was to make sure it was consistent with the corporations and securities power and the second was to enable a bit of finetuning. I would have assumed that it would have needed to be consistent with the corporations and securities power at the outset.

Mr Willcock—The bill was initially drafted for release in February to fit within the Corporations Law as the Corporations Law currently stands. The Corporations Law has been drafted on the basis of a cooperative scheme of arrangement between the Commonwealth and the states. In, I think, May—just shortly before the conclusion of the consultation period on the exposure draft bill—the High Court handed down its decision in the Hughes case. The Hughes case—on which, I am afraid, I cannot go into great detail because of my own lack of knowledge of it—

CHAIR—I understand; I have got a smattering of knowledge on it, like you.

Mr Willcock—The Hughes case gave rise in the Commonwealth's mind to fairly substantial doubts about the capacity of Commonwealth bodies, such as the DPP and ASIC, to administer and enforce provisions of the Corporations Law as it currently stands. That degree of uncertainty, therefore, was something which arose subsequent to the drafting of the bill as it currently stands.

CHAIR—Does that not go to the corporations power itself? Is that not the issue of the corporations power itself under the Constitution and its application rather than legislation we

might draft under the assumption of that power? I cannot understand why there is a need to review the legislation in that context.

Mr Willcock—As I understand it—and this is a bit of history that predates me—the Commonwealth initially attempted to enact the Corporations Law entirely under its own Commonwealth constitutional power back in the late 1980s. That attempt at enacting the Corporations Law as a Commonwealth law in its own right failed as a result of a High Court case. The Commonwealth and the states then cooperated in the late 1980s or early in 1990 and reached an agreement—the so-called Alice Springs agreement. That agreement developed a relatively complicated legislative framework relying on both the Commonwealth and the states enacting legislation—the Commonwealth enacting legislation under the territories power for the ACT and the states picking up the Corporations Law as enacted for the ACT and applying it in each of their jurisdictions as state law. So the problem that has arisen since the Hughes case relates not so much to a determination of the scope of the Commonwealth's corporations power but to that legislative framework—that vehicle of combined Commonwealth and state legislative action.

CHAIR—Is the issue about who can enforce it rather than about the law itself?

Mr Willcock—As I understand it, the problem with the Hughes case is that it gave rise to concerns about the capacity for Commonwealth agencies, such as the DPP and ASIC, to undertake certain administrative functions under state legislation. For example, when ASIC or the DPP seek to enforce provisions of the Corporations Law in states such as Tasmania or South Australia they would, in effect, be doing so under the Corporations Act of Tasmania or South Australia. As I understand it, the capacity for those Commonwealth bodies to do that has been the subject of some doubt where there is not otherwise a clearly referrable point of Commonwealth power that can be referred to.

There are many areas that the Corporations Law and the Financial Services Reform Bill cover which would amply come within Commonwealth power on any reading of the Constitution. For example, to the extent that the Financial Services Reform Bill involves some extension of the ambit of the Corporations Law to cover, for example, deposit taking products or insurance products, it seems to us fairly unambiguously clear that the Constitution affords the Commonwealth power in respect of those matters but that there are other areas of the Corporations Law as it currently exists—and the Financial Services Reform Bill would continue to apply a level of regulation to those activities—where there is some element of doubt. So the Commonwealth is dealing with the states and the Northern Territory to seek their cooperation to refer power from each of those jurisdictions to the Commonwealth to cover the subject matter of the Corporations Law and the Financial Services Reform Bill so that the Commonwealth parliament could then consider the enactment of a Commonwealth act under that referred power, which would, again, unambiguously be within the power of the Commonwealth parliament so to enact and remove the uncertainty that the Hughes case has given rise to.

Senator COONEY—Didn't the High Court say that, although the Commonwealth could confer power on the state courts, the states cannot defer judicial power to the Commonwealth courts?

Mr Willcock—I think there was certainly another case that arose last year—the Wakim case—which in effect deprived the Federal Court of jurisdiction in relation to large matters of the Corporations Law.

Senator COONEY—Didn't Hughes complicate it further? It is really a matter of whether we have a referendum or whether the powers refer.

Mr Willcock—The Wakim case, then the Hughes case—and I think there have been some other cases that have already taken place and that there may indeed be further cases that are likely to come before the High Court—have cumulatively exacerbated the areas of uncertainty regarding the Commonwealth's ability to regulate or legislate in this area and for various Commonwealth bodies and agencies such as the Federal Court, the DPP and ASIC to enforce—

Senator COONEY—At one stage it was South Australia and Western Australia that were a little unwilling to refer their powers. Has anything happened there, do you know?

Mr Willcock—I mentioned at the beginning that I am not such an expert in the matter of Hughes. My knowledge of Hughes is more involved with the implications of that case for the legislative track, if you like, of the Financial Services Reform Bill. I do understand, as you mentioned, that there are considered to be some options for dealing with the uncertainty that Hughes, Wakim and various other cases have given rise to. I think different states have put forward different views as to what the right option should be.

Senator COONEY—When you say that the uncertainty is the problem, I think that is absolutely right. The uncertainty is because there is a reluctance from the states and, unless we have a referendum, the uncertainty is going to remain, I suppose.

Mr Willcock—The problem at bottom is with the scope for the Commonwealth consistently with the Constitution to enact legislation that covers the subject matter of the Corporations Law and the bill. One way of dealing with that gap in Commonwealth constitutional power would indeed be by way of a referendum. The Commonwealth, however, thinks that a speedier fix, if you like, of that uncertainty—quicker than a time line that a referendum would deliver—would be by way of referral of power, which is another method provided for in the Constitution for this quick fix.

Senator COONEY—As long as they do not take it back.

CHAIR—What further finetuning was required, given that you would, I assume, have done some finetuning between the draft bill, having received all the submissions, and the first work on the final bill?

Mr Willcock—The truthful answer would be to say that we could probably finetune for as long as we had time available to us. We were initially aiming to comply with the government's espoused time line of having legislation ready for introduction in the winter sittings. That was our intention, and that is what we would have done but for the fact that the Hughes case, as I mentioned, gave rise to this uncertainty—not just with the bill but underlying uncertainty about the whole Corporations Law. The Attorney-General and the Minister for Financial Services and Regulation jointly issued a press release, I think in May, indicating that the top priority for the

Commonwealth at this stage had to be to address that underlying uncertainty that the Hughes case highlighted. As a result, the introduction of the legislation was put to one side in the interests of seeking that resolution. So, when I mention finetuning, it is simply to say that, since we have the opportunity afforded to us by that deferral to spend some more time on polishing up the bill, we are seeking to do so.

CHAIR—Among the concerns raised in some of the submissions that we have received—and I assume in some of submissions that you have received—is the definition of 'financial advice'. It has been argued that it is too wide and too indiscriminate—in particular, that it will capture front counter bank staff who are simply, in their view, disseminating factual information and that it will require banks to train staff up to the standards required of financial advisers and also to comply with product disclosure statements and statements of advice. Do you have a response to those concerns?

Mr Willcock—Certainly. You mentioned the particular situation of bank staff and the application of these provisions to deposits. I think, however, that is just one side of the industry that has been concerned about these particular provisions. There are possible implications for various people.

CHAIR—Building societies have raised it.

Mr Willcock—At this stage I might ask Vicki Wilkinson, who has been chiefly responsible for those aspects of the bill, to respond.

Ms Wilkinson—As Michael said, you have cited a particular example of concern with the definition of 'advice'. I think across the different sectors of the industry there have been concerns with the definition of 'advice'. I think it is fair to say that it has not been an easy definition to strike. Throughout the three consultation periods that we have had, it has been one definition that we have continued to work on.

The submissions that we have received—and undoubtedly the ones that you have received—have raised a range of issues with advice and with the different elements of advice. That definition is quite a complex definition. It takes in both personal and general advice. It includes an overarching definition as well. On the basis of the submissions we have received and the discussions we have had, we have continued to finetune and sharpen that definition to make its bite more apparent and to try to clarify the grey area that inevitably exists when you define anything. To some extent, the surrounding area is always grey. In particular, the issue that the banks have raised about tellers, or front counter staff, has also been raised by the insurance industry about their counter staff, and so on. We have worked to try to clarify that and to draw a clearer line between what is financial advice, given the things that hang off that, and what is not advice.

Embedded in the question you have asked is also this issue about what training attaches if someone is giving advice and what other obligations apply. Any one point in this bill leads to downstream effects, and so, in doing our finetuning, we have also finetuned a number of points. I do not think there is necessarily a blunt change that we can make up here. We have to manipulate all the knobs so that in the end we have reached a position that balances the interests of the industry versus the consumers. We have certainly taken on board the comments made by

the banks and other participants in the industry and tried to refine the definition to fit better whilst still ensuring that, irrespective of who the person is or what their name is, if the consumer receives advice then they receive the same levels of protection.

CHAIR—Another issue that has been raised is the impact of the rationalisation of licensing requirements, particularly from multi agents to single agents. That may trigger a capital gains tax event. What is your response to that concern?

Ms Wilkinson—We are particularly aware of the potential tax implications. Michael mentioned that we had had three roundtables during the consultation period. We also held a fourth that was specially focused on capital gains tax. We invited representatives from all industry associations who felt they were impacted by tax and by the FSR bill, including the agent associations, the brokers and IFSA. Included in those consultations were the ATO and the tax part of Treasury that looks at these issues.

During that consultation, industry had the chance to talk about what their concerns were and we asked that they provide additional submissions. Last week we received a submission that covers a broad range of interest groups, and we are now working on that with the objective of getting whatever tax legislation is required to facilitate this process in place and operating at the same time as the FSR bill commences.

Mr Willcock—I should say, however, that we are not directly responsible for the tax legislation. That is the responsibility of another area of Treasury and the ATO to develop.

CHAIR—But it is not the intention that such changes should trigger what we might call unintended tax consequences.

Mr Willcock—No, indeed. I think the general intention of the government, which was demonstrated at the time that the managed investment legislation commenced in July 1998, is that private individuals or business should not suffer any adverse tax consequences where they have to restructure their business arrangements to comply with new regulatory requirements. It is clearly seen that if the government itself chooses to change regulation then the consequent need for business and industry to change to comply with those new requirements should not then result in a windfall tax gain for the government. That would not be a very sustainable position.

CHAIR—Again in submissions we have received, and I think they would mirror submissions you have received, a number have argued that the bill does not reflect the intention of the commentary in certain areas. I think this is more in detail than in general principles—some of the detailed drafting of the legislation. Has that been looked at in the context of the finetuning you referred to, or is that simply a misinterpretation by some groups as to the effect of the legislation?

Mr Willcock—It can be both. I think it is fair to say that the legislation is not necessarily excessively complex, given the range and subject matter that it covers, but it is not necessarily something that the lay reader could easily pick up and feel intuitively that they have got under control. It has therefore been the case that we have noticed in some of the comments that we have received on the bill that people's comments have been misconceived or proceeded on a

faulty analysis of the provisions, or at least in our view a faulty analysis of the provisions. So from that point of view that tells us a couple of things. One, it tells us that to the extent that we possibly can we need to ensure that the bill more clearly puts the outcome that we are trying to deliver.

To the extent that there has been any consistent message where a particular provision has in our view been misinterpreted or the intention of it has come across in a way that we had not intended to come across, then there is clearly a need for us to ensure that that misconception is addressed and the legislation clarified. But sometimes, as I say, it may well be that people simply have a different view as to what the appropriate legislative outcome in the given area is. Different stakeholders have different interests that they perceive to be important and they put particular views that not necessarily every other stakeholder group which has made submissions would agree with. So it is sometimes a matter of in effect coming to a balanced judgment about the relative weight that you can attach to the various viewpoints that the stakeholder groups have put and lining it up against the provision itself to ensure that the appropriate policy position is reached. More often than not it is simply a matter of doing the finetuning.

The fact is that there are different tasks here. We have the job as the policy officers for developing the policy and giving the instructions to the Office of Parliamentary Counsel, which is responsible for turning those instructions into legislation. Different gifts are involved and sometimes it may be that we have inadequately conveyed to the drafter what we really intended to be drafted. If there was an obvious disparity between what the commentary said we were trying to achieve and what the particular provisions appear to give rise to, we would be seeking to get the provisions recrafted so that they more obviously line up with the intention in the commentary.

CHAIR—One example was the Institute of Loss Adjusters, who believe they were caught by the bill and believe that really their role was outside what the intended scope of the bill was. Have you any comment on that?

Ms Wilkinson—I think that probably was not an example of a misunderstanding. I think that was an initial position. That position has attracted a lot of comment and, again, it is one that has been revisited and looked at in the light of the hundred submissions. So I do not think that there was a misunderstanding. I think that was a policy position which the loss adjusters did not agree with. Other people commented on it at length as well.

Senator GIBSON—I am a bit concerned about the timing. We are running in parallel with the government's activity. We have obviously got 60-odd submissions and you have got a hundred. We can assume—and you have commented—that there is probably a lot in parallel in the two lots of submissions. I am a bit concerned about how we are going to get to an end point, whether we are making an input which the government takes notice of or whether the government was going to come up with its final review at the end point of your process, so that we can then have a look at that. I know that we are running in parallel basically to try to save time and I am aware of the great length of time since the initial proposal. People can hardly say that there has not been adequate time for consultation. I know you have done a lot of consultation. But I am concerned about us, in parallel, getting to the same common points. Could you give us some guidance about what you think we should be doing as a committee, timewise? Can you help us? When is the government going to give us guidance?

Mr Willcock—I certainly cannot tell the committee what it should do.

CHAIR—We need to know when we need to report by, in order to have our report taken into account in the final bit of finetuning.

Senator GIBSON—There are two questions really: there is that; and the other thing is that there is not much point in us going into great detail. For instance, the Insurance Council's submission contains a lot of detail. In your opening statement this morning, you said that you have given consideration to a lot of detail. Chairman, I wonder what is the point of us looking at a lot of detail when you have already been through the process—for a fair bit of it. I am also wondering about the best way out of running in this parallel process, even though I am sure that the whole committee is in agreement that we need to get on with it, we need to get an end result and we need to be able to implement it at the start of next year.

Mr Willcock—I suppose a few points that I should make are that the government does wish to introduce the legislation and seeks its enactment in the spring sittings. It is therefore aiming to seek a fairly early introduction in the spring sittings. So in terms of convergence of time lines, I am not quite sure what processes the committee itself had in mind in the course of conducting its inquiry or when certain steps will be taken, but we hope that the legislation will be introduced, as I said, early in the spring sittings. Depending on the committee's own work program—where it gets to by that time—it may or may not have also reported by that stage. It may possibly convert this inquiry into a process of actually looking at the form of legislation that is introduced into the parliament.

Senator GIBSON—That is the essence of the matter really. Can you guide us with your understanding of what will happen?

CHAIR—I was aiming to table a report on this as soon as we start sitting again.

Senator GIBSON—So before the government makes any statement about your process, the Treasury's process?

CHAIR—To get it taken into account. The other option is to have the information that we have garnered, see what comes out in the tabled bill, conduct a very brief inquiry into that if there are any further issues that we have not considered, and then do a report.

Senator GIBSON—That is just my query. I am raising this general query because I would hate to see further delays as a result of the process. I know the industry wants us to get on with the job and tidy it up. It is really a matter of how we can best do that.

CHAIR—If we get a clear indication that the government's final legislation is going to come in very early in the session, then the best option for us will be to hold over a report and incorporate the draft legislation and the final legislation into our report. If it is going to be some weeks down the track, and gets to the middle of the session before we get the legislation, we probably need to table that.

Senator COONEY—I suppose you could not avoid it if somebody wanted to refer it back to this committee and the Senate from the Selection of Bills Committee.

CHAIR—No, that is why I think we probably will have a hearing, albeit maybe even a brief one, on the final bill. The issue is whether we do a report on the draft bill and then a report on the final bill or incorporate both into the one report. That is what we have to determine as a committee privately.

Senator COONEY—What Brian was saying was essentially right. How much different will the final bill be? If you have a substantially different bill, you are going to get somebody in the Senate putting their hand up and saying they want an inquiry into this.

Mr Willcock—I think we would say that we do not believe that the legislation in general terms is going to be substantially different. What we have found by looking at the submissions is that the comments are less of a fundamental policy issue per se and more to do with how particular provisions are drafted, and whether or not particular activities or circumstances are caught and what the implications of that may or may not be. We have been more concerned with ensuring that we clear those sorts of issues up rather than holus-bolus remove some key plank of what was in the bill and put in place some dramatically new process.

Senator GIBSON—That is the question. There is little point in our going into minute detail from the submissions we have when you have already been through that process with the same people with parallel submissions. Therefore, Chairman, it would seem to me that it would be sensible for you, on behalf of the committee, to confer with the minister about the appropriate process to both our satisfactions.

Senator COONEY—I think a grand example of what Senator Gibson is saying is in the next submission which he has mentioned. That is from the Insurance Council of Australia Ltd. The council obviously has done all the work on this. Have they been dealt with or are these recommendations new to you?

Mr Willcock—We have addressed the submission. We believe that, to our satisfaction at least, we have resolved the issues that have been raised.

Senator COONEY—Did you answer this particular submission or did you answer a submission made in similar terms put to the department?

Mr Willcock—Sorry, I think we might be at cross-purposes. We have not provided written responses to the 100 organisations that provided us with submissions itemising or detailing the nature of any government response.

Senator COONEY—I was going to ask the Insurance Council of Australia when they came here about their recommendation that subsection 766B(3) should be amended to refer to what a reasonable person is in the circumstances. That is a concept that runs through the law, as you know. What did they mean by that? Would your section have answered that issue?

Mr Willcock—We have turned our minds to that comment, reviewed the provision of the bill and feel that we have satisfactorily addressed the concern or the issue that has been raised. That is not to say, however, that we have written to the Insurance Council of Australia or to any other people who have provided us with submissions, to say what the final position of the legislation will be. In effect, we believe it is not appropriate for us to announce what the government's

position is until the government has settled the final form of the legislation for introduction to the parliament.

Senator COONEY—You have anticipated my next question, I think. The department's answer to the issues raised by the Insurance Council of Australia is not available to this committee.

Mr Willcock—No, not yet.

Senator COONEY—Not at this stage?

Mr Willcock—The point is that the government's answer to all of the concerns or comments that are being addressed to us as part of this public consultation process will be the final form of legislation introduced into the parliament. There are not any letters or documentation that the committee could see or that we could hand over which would detail some item by item response per se. It is more a matter of us having looked at, and considered the implications of, the comments raised for the drafting of the legislation to determine whether or not that drafting is appropriate, whether or not we have achieved what we meant to achieve and what we should be aiming to achieve. If the answer is 'or not', we have then sought to clarify.

Senator COONEY—From our point of view, at some stage we—read 'the secretariat'—have to sit down and write a report which we pretend to understand. Then we send that off to both houses. If it is going to be a fair report, we have to address all the submissions put. If we do not quite know what the government is going to say, there is some difficulty in getting a report that is comprehensive at least.

Senator GIBSON—That suggests, as the chairman said before, it probably would be sensible for us to have an interim report on the submissions to us for tabling in the first week of parliament and then to keep the matter open for a short period when the bill is drafted so that we can tidy that up quickly.

Mr Willcock—I do not know if this is of any great assistance, but I vaguely recollect that, when the earlier Corporate Law Economic Reform Program Bill was the subject of an exposure draft, the committee at that stage undertook an inquiry process, the government subsequently introduced it into parliament and the committee then converted its inquiry from the exposure draft to the bill itself. I think that at the time, the department provided the committee secretariat with some sort of table or document that identified the changes between the exposure draft and the final form of legislation so that the committee could take itself to the new matter or the matter that reflected the outcome of the consultation process.

CHAIR—Yes. As I recall, some of our recommendations on the draft bill were picked up in the final bill. They may have mirrored other recommendations from other sources, but they were certainly recommendations we made.

Mr Willcock—That was all on the basis, of course, that the government was keen to facilitate the committee's own consideration and to ensure that the bill was enacted as speedily as possible. If that type of identification of any changes once the bill is introduced will assist—

Senator COONEY—I noticed, for example, in a submission from the Association of Financial Advisers, that one of Senator Alan Ferguson's staff, Kate Andrew, has told us that, where a bill triggers an unwanted tax liability, the situation is corrected by amending existing tax legislation at the same time. Do you agree with that?

Mr Willcock—I am not sure about the width of the statement but, as I said earlier, I think the government would certainly agree to the idea that, if there are any adverse unintended taxation implications arising from people having to comply with the legislation—

Senator COONEY—It is an illustration of how senators are very much at the mercy of people like yourself, Mr Willcock. We have to do the best we can in dealing with the inquiry and I think that, if we are to have a sensible, rounded and useful report, we need to know where the government is going, within a reasonable time. Senator Gibson talked before about the chairman's comments about an interim report, and that seems to be a way forward. What I am concerned about there is what it does to your timetable.

Mr Willcock—We will continue to do what we can to ensure that the legislation is finalised for introduction as early as possible in the spring sittings. I am not sure that I can take it much further, except to undertake to ensure that the minister is aware of this issue. The chairman also mentioned the prospect that, perhaps, he could discuss the issue with the minister.

Senator COONEY—As long as you take on board, and you have, that this committee has its own situation to look to.

Mr Willcock—Indeed. And I can see there is a problem, I suppose, of trying to coordinate the tracks we are on to ensure that, somehow or other, the time lines merge nicely, as opposed to cutting across each other in a way that gives rise to confusion.

Senator GIBSON—Particularly because there are not many weeks that we are actually sitting during the spring sittings, so getting all this through and going through the proper processes is going to mean a very tight time line.

CHAIR—I think we would need to get a report on this, a draft, in during that first week.

Senator GIBSON—Certainly a report to Minister Hockey.

CHAIR—As there are no further questions, thank you very much, Michael, and your colleagues, for your attendance before the committee this morning and for your answers to our questions.

Mr Willcock—Thank you very much.

[10.53 a.m.]

DRUMMOND, Mr Robert, Executive Manager, Operations, Insurance Council of Australia Ltd

MAGUIRE, Mr Philip Anthony, Deputy Chief Executive, Insurance Council of Australia Ltd

MASON, Mr Alan John, Chief Executive, Insurance Council of Australia Ltd

CHAIR—Welcome. We have before us your submission, No. 33. Do you wish to make an opening statement?

Mr Mason—Thank you, Mr Chairman.

CHAIR—You may proceed, and we will then move to questions.

Mr Mason—I would like to thank the committee for the opportunity to appear today. Robert Drummond is, with a large team of people from the insurance sector, the author of our submission so, in terms of the detail to which you have already referred, he will be well positioned to answer any questions.

If I may, I would like to make a few opening observations. The position of the Insurance Council of Australia is to support the legislation. We support its intent to achieve a single licensing regime and to achieve consistent consumer protection across the financial services sector. As a result of the bill, we are expecting to see improved efficiency and the removal of legislative impediments to business, which should ultimately result in reduced costs to business and, therefore, to consumers. It is a fact of life that convergence has taken place and continues to take place in the financial services sector, and this bill reflects what is happening in the marketplace.

I think it is probably important to record information about our membership. We represent close to 95 per cent of the general insurance business that is transacted in Australia. That means that we do not look after products such as life insurance, superannuation or health insurance. Consumers and business pay insurance companies in Australia some $17 billion a year in premiums. That is close to 37 million new, renewed or amended policies each year, which is a very high volume of transactions. The insurance industry returns to the public over 80 cents in the dollar by way of claims on that $17 billion worth of premiums paid every year. By that measure, we probably rank the most efficient market in the world in terms of payout to consumers. The transactions that insurance companies undergo underpin every facet of commercial and personal life—our homes, our cars, products we use, our personal injury and so forth.

In our view, the bill does not seek to address any direct problems that exist in the general insurance sector. Most of the existing procedures, the documentation, policy forms and proposal forms—those sorts of things that the insurance industry uses—largely follow the general design

of the regime envisaged by this bill. The insurance sector has had a consumer protection regime for many years in Australia. This includes the industry's own code of practice, the Insurance Contracts Act and the Insurance Agents and Brokers Act, which give a very rounded set of consumer protection regimes. We see that the main purpose of this bill is to give harmonisation and consistency across the whole financial services sector. I would also make the point—and I will come back to this—that the general insurance sector is subject to an enormous raft of state legislation that governs insurance contracts and the sale of those contracts. That includes workers compensation, compulsory third party motor insurance, strata title insurance, home builders warranty insurance, various professional indemnity and public liability schemes—and I could go on.

The Wallis report did not actually make any specific recommendations relating to the general insurance sector. The thrust of our submission is that the existing products, documentation, disclosure regime and sales practices that exist in the general insurance sector should be recognised. They should not be compromised by the changes that are applied across the board. I think we need to recognise that insurance is, generally speaking, a low-cost commodity. It is not an investment. It requires very little advice. It is high volume. For a lot of the consumer products, the consumer, largely, has a general appreciation of what he or she is trying to buy. That is important because so much of the business sold by insurance companies to consumers is not sold through intermediaries. A lot of it is sold direct over the telephone or by direct mail and, increasingly, I am sure, it will be sold over the Internet. So the new regime has to be flexible enough to allow for the different distribution mechanisms that exist in the insurance industry—agents, brokers, direct selling and so forth—without compromising any of the existing delivery mechanisms or the cost to consumers.

In so far as the licensing proposals in the bill are concerned, in a general sense, they do not represent a problem to us because we have the Agents and Brokers Act that governs the licensing of brokers. Every agent that acts for an insurance company already has to have a contract with that company to act as an agent, and our code of practice deals quite extensively with the authorisation, training and competency of our intermediaries.

We have raised a couple of issues in our submission, apart from a very large number of issues relating to disclosure, which we recognise as being particularly difficult. We have raised the issue of state regulation because, whilst the bill is seeking, quite commendably we believe, to harmonise the regulation of financial services across the board, more than 50 per cent of the products in our sector are governed by state legislation and they are left out of the ambit of this bill. We do not in any way shy away from the difficulty of that position; we understand that all too well. As an example, in New South Wales brokers are precluded by legislation from dealing in workers compensation insurance. In Western Australia they are permitted, but a report has just been released in Western Australia that proposes the introduction of competency and disclosure regimes for brokers in that state. This bill, again, deals with licensing, competency and disclosure but in a different manner. This complication of state legislation and Commonwealth legislation adds enormous inefficiency costs to our industry.

The other issue we have flagged in our submission is the growth of e-commerce and Internet sales. We will have, hopefully when this legislation is passed, probably a world best practice regulatory framework for financial services, for disclosure and for licensing. We would hope that some mechanisms can be delivered to add endorsement value to companies that are

licensed under this regime and that we do not create an arbitrage so that people who are not licensed and not regulated can achieve some cost or other advantage, sell products to consumers and not have the same quality of endorsement. That concludes my opening comments. We would be very happy to take questions from the committee on any detail contained in our submission.

CHAIR—Thank you, Mr Mason. Firstly, in your submission you make the claim that 'providing adequate consumer protection and information must be balanced against the additional compliance costs that will be imposed by the provisions of the draft bill'. Are there any particular areas of the bill where you think the balance between consumer protection and the cost of compliance has not been achieved?

Mr Mason—I will pass to Robert but the one that strikes my mind is a typical transaction where, let us say, somebody phones an insurance company to buy a motor car insurance policy over the telephone. It is the processes outlined in the bill which we think would add cost and not a lot of benefit. Robert, would you like to expand?

Mr Drummond—One of the points we have tried to make in this submission is that the processes and the documentation provided by insurers to their customers or prospective customers already go a long way towards satisfying the kinds of requirements envisaged by the various disclosure documents in these provisions—that is, the financial services guide and the product disclosure statement. What we are concerned about is that we not be faced with the need to reinvent a whole new suite of disclosure documentation. We are already providing a very high standard of disclosure in the documents that we issue. That is one aspect where we believe, if the provisions were strictly interpreted, unnecessary cost without any added benefit would be imposed on us.

CHAIR—Have you made any estimates of the cost to the industry of the additional compliance measures?

Mr Drummond—We have not but, as Mr Mason explained, we issue something like 37 million policies a year, or renew 37 million policies a year. So if the industry were faced with a suite of three separate disclosure documents for every one of those documents, you begin to get some idea of the costs involved.

Mr Mason—The typical motor car insurance transaction consumer generally knows that they want to insure, let us say, a 1996 Commodore, so they will phone a range of insurance companies to obtain terms. That process does not, at this stage, require the consumer to be given the full product disclosure, a needs analysis, et cetera, before that transaction is entered into. In fact, we have grave doubts that we would hold the consumer on the telephone for long enough to complete that.

Senator GIBSON—Where did you get to in your discussions with Treasury on that issue?

Mr Maguire—When we spoke to Treasury, I think they were in a position to provide an answer which is probably fairly similar to what they were able to give the committee this morning, which is that their view is that it is a position for government to be able to respond to the submissions that have been made. The way they are going to do that, essentially, is through

the legislation planned to be tabled in August. At this stage, about 59 recommendations have been made. We are not aware of what the exact position is on any one of them.

Mr Mason—We would be hopeful that the logic—which is apparent to us at least, but which may not be consistent with everybody else's view; we recognise there are competing views—will be recognised in the final bill. I suppose the concern that we do have is that some of the recommendations that we have made—in fact, a large number of them—are fundamental to the efficient transaction of insurance. If they are not recognised in the final bill, which is going to be our next opportunity to see how persuasive or not we have been, then we may or may not have concerns.

Mr Drummond—As you recognise, our submission is very much concerned with the detail of the bill. There is an awful lot of detail here. At face value the bill appears to be bogged down in the details. But if they are left unaltered, they have the potential to very seriously impact on the efficiency and the smooth running of our business and the service to our customers. The response that submissions are being dealt with in a broad sense by amending the bill, but without commenting in detail, just leaves us a little concerned at this stage.

CHAIR—We will take that into account, certainly. I know your submission supports a more flexible disclosure regime, but you also appear to be calling for more prescriptive legislation so that there is less reliance on subordinate legislation and policy statements of the regulator. To me, there seems to be a bit of inconsistency in those two positions. Is that because you have got a lack of faith in the regulator to properly regulate the industry or do you really want more prescriptive legislation? Can you just clarify that?

Mr Mason—Perhaps I could clarify that. I think that when we are asking for flexibility, we see that the regime needs to have flexibility to deal with the different types of product so that you do not have the identical requirements for different ranges of products. In terms of black-letter law, however, we are selling a product which is, in essence, a contract between the insurance company and the consumer. We need certainty to be able to deliver that product, to price it and to deal with it generally. We have a preference for those things and for things as critical as the licences of an insurance company or its representatives to be expressed, as far as possible, in legislation so that people have certainty in what they are dealing with.

We have a concern, and one of the recommendations in our submission is that the regulator should not have unilateral powers to suspend or cancel licences without consultation with the other regulator—which is APRA—and without giving people appropriate rights of appeal and representation before such decisions are made. We can understand the merits of flexibility in some circumstances, but I think that when the circumstances go to the heart of the livelihood of a person or ability of an insurance company to transact its business, as far as possible, black-letter law has to be preferred.

Senator COONEY—I am looking at the context of the need to have some assurance of exactly what government requires while at the same time trying to get a position where flexibility is given a proper sphere to operate in. I am looking at the recommendation that says subsection 766B(3) should be amended to refer to what a reasonable person, in the circumstances, would expect the provider to have considered. It is on page 31. That is a classic situation where you cannot say from circumstance to circumstance what the position is going to

be, so you leave it ultimately up to the courts, if it comes to that, to decide what is reasonable in the circumstances. I say it is a classic situation because it is a problem that faces society not only in this area but generally, regarding what in any particular circumstance might be reasonable. You really cannot define that, but the council seems to say, 'We want you to define that.' Have you any thoughts about that? What I am really asking you is this: are you perhaps asking too much there for this legislation to be so prescriptive that it covers absolutely every situation that arises?

Mr Drummond—What we were looking for was certainly a greater level of certainty than appears in the draft provisions at the moment and in the commentary describing them. We felt that the nature of the transaction was such that the way that it is expressed at the moment is just too uncertain. We would hope that the so-called fine tuning will address that and give us a greater level of certainty.

Senator COONEY—One of the difficulties that I find is that there are a number of recommendations, all of which are in need of analysis by this committee. I think that they are all matters of some moment. I am just wondering how we are going to deal with them in the time that is available to us, how we can do justice to the various recommendations that the council has put forward.

CHAIR—I would propose that we consider them along with the evidence that we are taking at our hearings. But we would certainly give attention to them, even if they are not fully explored at the hearings, to take account of them in the consideration and drafting of our report. We have certainly got the expertise within the secretariat to assist us in that regard.

Senator COONEY—You say section 766CF should apply only to an insurance claim settlement where a licensee—for example, a broker or an authorised representative of a broker—is offering claim settlement services to or on behalf of retail clients. If we were to ask about the context of that, that would take up time and then we would be going on to another one, so I am just wondering as a matter of procedure how we can get through this.

CHAIR—If there are any particular issues that you want to explore in questions, then I think you should explore them at the moment.

Senator COONEY—We could start off with each recommendation and go through it bit by bit.

CHAIR—Even if there are one or two there that you consider are perhaps a bit higher priority than the others and that you want to raise.

Senator COONEY—We are always asking—not on this committee but generally—if people would take questions on notice. I wonder whether the situation could be reversed and we could prepare what we would want to know and send it to the Insurance Council, so that the onus is on us.

CHAIR—That could certainly be done.

Mr Mason—We would be very happy to respond.

CHAIR—I have a question about your recommendation that factual information about general insurance products be excluded from the definition of advice. Is your concern about the cost of your products being caught up in that definition in terms of the statement of advice and the product disclosure documents required and also potentially the training of staff in that area? Could you enlarge on your concerns there?

Mr Mason—Each of those areas is included in the concerns, certainly the training of staff back to the point that an awful lot of these transactions are low value, high volume. They are a commodity purchase where the consumer, the prospective purchaser, is not really looking for advice; they have a fairly clear idea in their mind what they want to buy and therefore are not seeking advice. Where they do seek advice, that is usually available through brokers and other intermediaries. Robert, do you want to expand on that?

Mr Drummond—One of the concerns there was that the concept of separating factual information from advice was clearly set out in one of the earlier papers. It also found its way into ASIC's policy statement 146. But it is a concept that appears to have disappeared from the draft provisions. It is certainly one that we would like to see carried forward in the bill.

Senator COONEY—Is there some difficulty in making a defined separation between factual information and general advice? When you are giving general advice you have to pay some attention to the facts, I suppose. I am not sure how ASIC is thinking. Is it really possible to make such a clear distinction between advice and factual information? When you are writing advice you usually refer to facts and circumstances.

Mr Drummond—We have tried to give some help in our submission as to how we might define factual information. It is the giving and receiving of factual information between the potential customer and the insurance company staff, sufficient information to identify the need of the customer. For example, car insurance would be an applicable transaction—the type of car, the make, the age, and so on. The operator should be able to ask sufficient questions in order to advise the potential insured what the premium is likely to be and then the terms and conditions attached to the policy. So we would see that as the gathering and giving of factual information rather than seeking to identify the range of personal details of the consumer and match it with a specific product. I think it brings home the commodity nature of a general insurance product as opposed to a savings or investment or superannuation product.

Senator COONEY—I was wondering how it would work. The potential client rings up and says: 'I have a problem. Can you cover my car insurance, my house insurance? This is my situation. This is the car. This is the house.' The insurer would look at it and then quote some premium and give advice about that.

Mr Drummond—Not necessarily. Advising the premium, we believe, is not necessarily giving advice. It is not necessarily saying: 'This is the policy we recommend' or 'Under your particular circumstances, your family circumstances, your financial circumstances, this is the product and the cost that we would recommend for you.' The consumer is simply making an inquiry about a commodity, particularly the price of that commodity, and the answer they are given is factual information about the price of that commodity.

Senator COONEY—I suppose we would have a definition section in the legislation to say: 'In this act "advice" means so and so and "facts" means so and so.' Have you any concept of what would go into 'advice' and what would go into 'facts' for the purposes of the legislation?

Mr Drummond—In the submission we have attempted in general terms, or lay terms, to describe what 'factual information' might be.

Senator COONEY—I think that is on page 14 or thereabouts, perhaps page 13.

Mr Drummond—Providing factual information to a retail client would include explaining the features and benefits of the product, answering routine questions about the product, collecting basic information about the customer's circumstances in order to assess the risk to determine the value of cover required to calculate the premium. We believe that that is a reasonable definition or scope of 'factual information'. To offer advice beyond that would require a more detailed examination of the sorts of circumstances that one normally reveals when one is looking for an investment product or a superannuation scheme, which is just not present in a typical insurance transaction.

Senator COONEY—So it is in that context that you would say, 'Well, look, you draft it'?

Mr Drummond—Yes, and, 'I can show you a Commodore. This is the product and that is the price.' That is usually the only level of information that the customer is interested in.

Senator COONEY—And after that transaction if the person wanted to ring up the investment company you would say there is a difference in the relationship?

Mr Drummond—Yes, 'This is my income. These are the investments. These are the funds that I have ready to invest.' There is a whole level of detailed personal investigation needed. That is the difference.

Senator COONEY—Yes, and it is in that context that you say there should be a difference.

CHAIR—As there are no further questions, Mr Mason and colleagues, thank you very much for your appearance before the committee this morning.

[11.26 a.m.]

CRAWFORD, Mr Hugh, Member, Public Affairs Committee, Association of Financial Advisers

HIBBERD, Mr John, President, Association of Financial Advisers

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

CHAIR—I now welcome the representatives of the Association of Financial Advisers. We have before us your two submissions, Nos 8 and 59. Would you like to make an opening statement before we proceed to questions?

Mr Hibberd—Yes. Thank you for giving us the time to put our case in regard to the draft Financial Services Reform Bill. As you are aware, we have made several submissions to your committee. This morning I wish to speak briefly to a number of points that we have made in our submission. Our association is a professional association which is now over 54 years old and has been the industry voice for self-employed financial advisers for that time. The majority of our members are self-employed small business people delivering sound financial advice on insurance, superannuation and investment to the Australian public. We are part of the financial advice industry of over 14,000 advisers, largely self-employed small business owners, with a total business value of $5.5 billion, according to ISFA, and assets under advice of $550 billion collectively—not small business, but big business.

Our submission concentrates on the following areas of concern, and I will just emphasise three of these in my little talk. Firstly, we are worried about a problem over advisers' right to work in the proposed legislation; tax issues, including capital gains tax liability triggered by the legislation and alienation of income; and changes that may affect the value of our current business. We are concerned also about the professional body exemptions, that professional bodies may not provide appropriate advice. And on the commission disclosure issue we are concerned about a level playing field for all advisers. The last two points in our submission are concerns about the transferring of competency standards—it is not yet clear how that will transfer—and cross-endorsement.

Let me emphasise three points: firstly, advisers' right to work. The FSRB, in an effort to move advisers to be regulated under one authority, substantially changed the relationship between the adviser and the product provider. Currently, the advisers' right to recommend life insurance products and some super products is controlled by agency law—that is, the agreement between the product manufacturer and the adviser. Under the FSRB we are moving all of these arrangements to the Corporations Law model. Under these arrangements a principal dealer is interposed between the adviser and the product manufacturer. In recent times we have had several cases where the action of principal dealers has put advisers out of business for periods of more than two or three months. Therefore, it stops their right to earn income.

In all of these cases we have looked at, it was the bad management practices of the dealers that caused a problem, not the provision of inappropriate advice. In every case, the adviser had

not broken any laws. The FSRB makes no provision to avoid this. Further, the bill seems to increase ASIC's regulatory power over advisers. The current draft gives ASIC power to ban advisers without a hearing. It is a case of being guilty before proved innocent. This is different from the law, as I understand it. As we see it this is not good news for our advisers. Maybe there should be some provision for arbitration to be written into the contracts between advisers and principals or the bill should revert to the current agent that brokers that situation in regard to manning provisions. This is a very important issue.

The commercial value of agencies is as self-employed business owners. The value of our businesses, being the future sale price of continuous income, is underpinned by a relationship between the manufacturer and ourselves or the operating companies of agents. As stated above, FSRB changes the relationship by interposing a dealer principle. This moves the ownership of the income stream to the dealer, who may now take a dealer's cut. These changes may well affect the current value of our businesses. IFSA has said these businesses are worth $5.5 million.

On commission disclosure, this has been a matter of lengthy discussion. As an association we agree with disclosure on investment and superannuation products where the results are affected by the amount of commission paid. However, on pure risk products, where the commission does not affect the price of the product or its outcome, we can see no reason why commission costs built into the risk products should be revealed, as it will not help to have a consumer make an informed decision on the choice of their insurance cover. If there is any disclosure on risk products, the association's position is that it should be total distribution costs and not just commission.

There are contradictions in attachment A in respect of this and in the draft explanation to the bill. The statement of the minister at the launch of the legislation did not clarify it. Two recent letters from the minister still make this very confusing. We believe that one of the letters from the minister's office is probably the one to believe. It said that when advisers receive a benefit it must be disclosed. We have a problem with that because advisers are receiving a benefit—that is, a commission. That is what they get paid for doing their job. The other problem is it does not provide a level playing field between the employed adviser and the self-employed. As we said in our submission, the principle behind FSRB of one regulator to supervise and deliver financial advice is good. However, we are not convinced that our members' benefits will not be badly hurt by the passing of the bill in its present form. Thank you.

CHAIR—I understand you have no objection to consumers having access to information with regard to commission disclosure. But you believe that the proposed regime places an unfair compliance burden on your members, mainly being small business operators, because they operate on commission as opposed to large companies who operate on a salaried basis. Is that one of the areas of your concern?

Mr Hibberd—The current draft legislation, as we understand it, says that if I am an employee I do not have to reveal the commission but if I am self-employed I have to reveal the commission. So, when selling a life insurance product, there is the same job and a different disclosure regime. We think that is crazy and not consistent.

Mr Mitchell—This problem is much bigger now than it was 10 years ago because of the banks. The banks are into this business. Mostly the bank advisers are salaried. The bank salaried officers have a huge advantage over self-employed people. They do not have to disclose their salary because that is not a benefit.

CHAIR—Will consumers face a difficulty comparing the net returns of financial products if self-employed people are hit by disclosure and the employees are not?

Mr Hibberd—We are talking about disclosure on risk products. We already said that, for investment products, superannuation, unit trusts, we are happy for the disclosure or commission to be revealed because it affects the return on the product. If I take three per cent, there is three per cent coming out. If I take one, that is only one per cent. But in terms—

CHAIR—Can I interrupt there. Are there no salaried employees involved in selling those sort of products?

Mr Hibberd—There are salaried employees involved in selling investment products, yes.

CHAIR—How do you get a level playing field in that situation if you have to disclose your commission and they do not?

Mr Hibberd—The point we make is that in both cases there should be the same disclosure so that the consumer can make an informed choice.

CHAIR—That is why you are arguing for this total cost disclosure rather than the commission disclosure approach in that segment.

Mr Hibberd—Yes.

CHAIR—Could you complete the second half of the answer that you were talking about—general insurance products.

Mr Hibberd—The problem is that the majority of advice is delivered by the self-employed group. We do not have a problem with the right of salaried employees—that is cool, if they want to do that. We just think a consumer ought to be able to compare apples with apples. We think that is reasonable. We think that for risk insurance where the commission is built into it, changing the commission structures does not do anything to the price of the product. One of our concerns is that, if people focus on how much we get paid for it, they are not going to adequately insure. The problem of inadequate insurance is more social security costs. We do not think that is good public policy in any way, shape or form, and we know that Australians are substantially underinsured—the article in the money section of the *Sydney Morning Herald* on Saturday talks about trauma insurance and the under insurance of people.

Mr Mitchell—Colonial, for instance, are selling, say, disability policies through their agents at the moment where they have to disclose commission and they sell it through salaried advisers who do not have to disclose commission under this idea. They have bank employees who do not have to disclose commission either because they are being paid a salary. It is not a level playing field and really it should be.

Mr Crawford—With these products, the cost of acquisition of business is the same in every case. Dugald was talking about a Colonial product. It does not matter whether it is sold by someone at a bank or by a commissioned agent, the acquisition cost allocation is exactly the same and it does not have any bearing at all on the quality of the product. It is a product that is identical and one would have to disclose commission and the other would not.

Senator COONEY—As far as risk products are concerned, are you saying that there should not be any disclosure, but if there is it should be disclosed by your own industry, by the advisers and by the bank, or should it be disclosed in respect of each of the salaried officers that give the advice?

Mr Hibberd—We think that disclosure should be made at the point of sale. The current position for investment products is that you do what we call a customer advice record and on the bottom line it says, 'Three per cent entry fee, two per cent commission.' Coming a bit further, we think that total distribution costs for a risk product should be put in.

Senator COONEY—Say it is a bank, the bank puts in a 'bank so and so,' and at the bottom what it cost.

Mr Hibberd—When they do the deal, they have to give a paper trail, a customer advice record. On that customer advice record they should put disclosure. Alternatively, it should be total distribution costs. When you look at a risk product, there is the price of buying the risk—that is, the insurance company buys the insurance on a reinsurance pool—there are the distribution costs and there are the administration costs. In the risk pool, when they buy risk insurance, reinsure it, they get a share of the profit in that risk pool. If the actuaries calculate wrongly, the life insurance company from the reinsurer may get a reimbursement of costs, so they will get some money back from the reinsurance pool and that is not revealed. Total distribution cost says that all the costs should be revealed so the consumer says, 'Hey, it's come from here, it's coming from there, this is how much the company is paying to run this product. Why is this company paying 20 per cent more than that company to run this insurance product? Why should I deal with them? They're inefficient.' I am not saying companies are inefficient, but if you look at total distribution costs, it shows the effectiveness of what is happening

CHAIR—So your concern in this area is the effect on the attitude of the customer by not having information across the board rather than perhaps the compliance cost aspect from the point of view of the agent?

Mr Hibberd—Yes, compliance cost has added a third to the cost of the business over the years. We agree with the code of practice which came in five or six years ago. The code of practice for life insurance gives a quite clear definition of how we should go about the transaction. We think the code is brilliant. Our problem with FSRB is that it has added to the code. It has made even the simplest transaction so much more complicated, and it has added cost to the business. I guess that currently our businesses are covering that cost. Obviously, as business people, we would like the consumer to be informed, but we want the business cost to be reasonable. The compliance in this financial advice area has, in our opinion, become unreasonable and ineffective. It is not doing anything. They are not reading the stuff we are giving them, unfortunately.

Mr Mitchell—We have been talking about two factors, but to get back to the self-employed agent as against the big end of town and the bank, the self-employed agent is at a grave disadvantage. He has to say something which, to the consumer, may be detrimental—that is, disclose the amount of commission he receives—whereas the person in the bank and at the big end of town is not going to do that.

Mr Crawford—We have a submission here from David Goodsall, who is Director Actuarial Services at Ernst & Young. It is a bit over a page. Can I read it and then submit it to you?

CHAIR—Certainly.

Mr Mitchell—The committee already has a copy of that.

Mr Crawford—It states:

ACQUISITION EXPENSES INCURRED BY LIFE INSURERS IN RESPECT OF RISK PRODUCTS

You have asked us to outline our market knowledge of the composition of Life Insurance premium rates for risk products. In particular you requested that we illustrate the component of the premium necessary to cover acquisition costs. Such costs include:

- distribution and financial advice (whether by commission to external advisers or to a salaried sales force);
- underwriting;
- administration and documentation.

We have experience of a range of companies that operate in the Australian market including those selling through:

- salaried advisers
- commissioned advisers
- a network of bank branches.

We do not have sufficient detail to enable us to produce meaningful figures for distribution and advice costs for those companies that remunerate separately their staff by salary and performance bonus rather than by commission. Indeed it can be very difficult to calculate such costs on a basis consistent with the commissions paid to other advisers, especially where sales are made through an existing network of bank branches. Reliable information of cost allocations between the bank branches and the life insurance operations are often not readily available, though anecdotal evidence and our own experience suggests the overall distribution costs are similar. As a result disclosure of commission is not of great help to the consumer in making the buying decision as it does not provide information on the relative cost structures of competing products.

We have collated the following information for three sample insurers selling risk products. These three represent the range of distribution methods in the industry. In order to avoid spurious accuracy in figures that are hard to reliably and consistently measure we have rounded the figures to the nearest 5%. The figures represent the proportion of each premium that is an average needed to meet the various outgo under the policy.

There are four areas of major cost in a policy—acquisition costs, maintenance costs, policy benefits and profit—and the table in the letter gives a sample of three insurers with which this company deals. The letter further states:

You will notice that the cost of protection is similar in each case, which is not surprising as market pressures dictate prices to a certain extent. The variance in costs, and therefore profit margins, does not appear to me to be driven by the method of distribution. Rather it is driven by the cost base of the insurer of which commission in only a part.

In the examples above the company with the highest expense base—

and this is rather illuminating—

pays virtually no commission, but the cost of its marketing structure is very high.

I think that really illustrates the point that we are trying to make—that is, that commission is only an acquisition cost of a different nature and really does not reflect in any way the quality of the product.

Dr SOUTHCOTT—On the capital gains tax side, you mentioned that you had met with the tax office and that they were confident that moving from one contract to another would be a disposal of an asset and subject to capital gains tax.

Mr Hibberd—An update on that is that we made a joint submission with ISFA and all industry advisory bodies to the Treasury law division, which is putting the FSRB together. That went only last week.

What we have done, which we can make available to the committee, is put a submission together on capital gains tax issues. We had a meeting with Treasury and the tax office a couple of weeks ago. The problem is that, as we move from one to the other, it may generate capital gains tax. They said, 'There is already the $5 million rollover provision.' We said, 'We want that provision to apply when I want to retire, not because you have changed the regulations.'

Dr SOUTHCOTT—So you are saying the current small business rollover capital gains tax provisions would apply in this situation.

Mr Hibberd—Absolutely. But the problem is they were saying, 'It will apply and you will be cool.' Hang on, the government has changed the regulation. I should be able to apply that when my members wish to retire because that is what we put in for and not because we have changed the rules. We have had to encourage the tax office to look seriously at that and they have now put three people on it. I am not sure if you have that submission but we can make it available to you.

Mr Mitchell—I just make the point that we have not got rollover yet. What was said at that meeting was that it would be sensible to have it. What they did say was that there was a trigger caused by the legislation. They saw that and accepted that. Now they had to find a solution. But they said it may be hard to find because they were creating precedents. We have not been told by the government, or there has not been an announcement by the government, as we understand it, that the capital gains tax issue is allegedly a rollover.

Dr SOUTHCOTT—The point I was making is that we have had for two or three years now a capital gains tax rollover provision which applies to small businesses. That is what I was talking about. The general provision which I think would capture most of the—

Mr Hibberd—The answer is the general provision should apply as it was put in when businesses make decisions, not when government makes decisions.

Senator GIBSON—Your thesis about total distribution for risk products is that total distribution costs should be disclosed. I pose a problem to you. If I was a bank and had my distribution network and everything set up for my normal banking business and decided to go in to add a risk product distribution on the same system and, starting off, only one per cent of revenue was coming from these risk products, how do I cost to the bank the cost of doing this? Would you do it on a marginal cost basis or an average cost basis?

Mr Hibberd—I think there are two issues. One is that the commission costs can be put in because that is built into the product, so when they put a product together in—

Senator GIBSON—But if you have only employees.

Mr Hibberd—Okay. When employees are buying life insurance product, normally when they put that product together, unless they have run a special product with no commission content, most insurance products are set. There is a distribution cost that is put in. They can tell you what that is.

The second issue is that all those advisers, even though they are paid a salary, are mostly on some sort of performance system, which we have said. So the answer is: if I do not produce something like $5 million of assets coming in—and we cost risk insurance in that—I do not get to retain my job and my salary. All we have is the same job but a different remuneration system.

In terms of how the bank costs it in, it knows what it costs to run an adviser. It simply knows to sit at a desk and to have the computer. To do all that is the same as it costs any of our members. They know what it costs to run that. In fact, as far as I understand it, they know what their financial service division costs and they have budgets broken down. They can say to run that adviser costs me X dollars and to run that product costs me Y dollars. Let's put the product distribution costs out on the table to say this is what it costs me to run it. If they can run the product more efficiently than another company, so be it.

Senator GIBSON—Sure, but there is still this marginal cost versus average cost problem for something like a bank. They have got all the facilities, their buildings, their computer systems, space, people, admin systems, set up and basically paid for by their normal banking services. If they add into that only a few people selling risk products on salary plus performance pay, which costs actually go in, on your proposition of total cost of distribution? The salary of the people doing the job is easy, their performance pay is easy, but the bank quite rightly say, 'I don't need any extra space, I don't need any extra computers, I don't need any extra telephones.'

Mr Hibberd—Let them put the cost into their product if that is the case. The fact of the matter is that they may have a branch, and that is true, the lights might be on, so it is only the cost of the desk and the computer. Let them put that in; that is fine.

Senator COONEY—I suppose you are also saying, from what I gather, that they say to you, 'You be transparent, apart from how much it costs,' whereas they are saying to the banks and what have you, 'You don't have to be transparent.'

Mr Hibberd—That is exactly right, and we think that is not reasonable.

CHAIR—Can I ask you to enlarge on these issues you raise in your second submission about servicing rights and cross-endorsement? I guess this goes to the imposition of this new role of dealer as against just adviser.

Mr Hibberd—The current position for life insurance is that I am a life insurance provider, I have got an agency and that agency is with the manufacturer who produces the product, the direct line. The Corporations Law puts the dealer in. What happens now is that if I want—

CHAIR—Under this new bill, you are saying.

Mr Hibberd—Yes, under the new bill. So when I deal with five insurers I get agency deals with five insurers. Under the new bill it says you have got to have an entity here called a principal, so I go to the principal and say, 'Find me these five insurance companies.' The five insurance companies bring the money down to the principal and then the principal sends the money off to me.

CHAIR—Does the principal exist now?

Mr Hibberd—The principal now exists under the Corporations Law for investment products and some super products.

Mr Mitchell—But there will be new ones.

CHAIR—So it is interposing a new group of people.

Mr Hibberd—That is right. So we are converting all this direct relationship between myself and the product manufacturer straight over into the Corporations Law. It is simplistic what I have put but it is the truth with the new model. Dealers currently say, 'It costs me to run my dealership. I will charge you 20 per cent to be in my dealership.' The fear of our members is that they will take the 20 per cent out of their life insurance commissions, which is not taken out now, and that affects the value of our businesses. The other question is that currently under the Corporations Law the right to do things is vested in the principal, not in the adviser, and we are still working through that, so there is a direct relationship. We agree with the FSRB; we have no problem with that. These are just some unintended consequences that we need to make sure our members are protected from. The problem at the moment is that, until the bill gets in, the life companies and the principal dealer groups are still working out how they are going to operate.

CHAIR—You are quite satisfied to have that principal dealer provision in there, or would you prefer not to have it in there?

Mr Hibberd—We would prefer to stick with the current agents and brokers model, but the government has decided to put in this Corporations Law, and we lost that.

Mr Mitchell—The Wallis committee did.

Mr Hibberd—So we lost that argument around these tables three years ago, I guess.

Mr Mitchell—And it is not much good going on about what we had before, so we have accepted the situation, but we have got problems. So far as the cost endorsement is concerned, we are concerned about that because I, for instance, have agents with different companies. To get that, I need to find a dealer who has got the same mix as I have got, or any agent has got, of the policies that we are now selling. If I cannot find that mix, a couple of things will probably happen. One is that there may have to be a replacement of policies. We are against that, we do not want that to happen, but there is a possibility that that may happen because you cannot get the right mix with the dealer. The Treasury is saying, 'Well, look, cross-endorsement is possible.' But there is a change in the relationship between a customer and the adviser in the new legislation because the dealer has all the responsibility for advice now and under the agent and brokers act that is not so, so there is a change there.

Because there is that liability for advice, the dealers say, 'We're not going to share that liability with any other dealer.' That is what cross-endorsement is. Cross-endorsement is holding more than one proper authority from a different dealer. But there is nothing in the industry at the moment which is saying that there will be cross-endorsement. So we have really got to find one dealer. If you are dealing in fire, in general, superannuation, life assurance and managed investments, you have got to find a dealer who has the recommended lists that you want. We see that as a difficulty, and I am not too sure how it is going to be solved. But it is certainly a major change.

CHAIR—Can you briefly explain to me the role of the dealer as against the role of the agent in relation to the customer? From what you have told me, under the current system you operate directly from the insurance company—you deal with the customer—but now you are going to have this dealer interposed, who you say is responsible for giving the advice. Does this mean that you do not give advice any more? Can you just explain the two roles?

Mr Hibberd—Under the Corporations Law model, the dealer is responsible for the advice given by his proper authority holder.

CHAIR—Which is the agent?

Mr Hibberd—Which is the agent. He is totally responsible.

CHAIR—So it is a responsibility rather than an action.

Mr Hibberd—It is a responsibility thing. Under the Agent and Brokers Act, the agent has some devolved responsibility to deliver good advice. It is related to how he delivers the information on the product, not so much about advice. Under the new model, the dealer is responsible. That means that the dealer wants to make sure he does a good job, so it adds to the compliance regime. One company has built a whole floor just for compliance—20 or 30 people doing just compliance and financial plans to control their compliance issue. So he is responsible. Because he is responsible, he is adding to compliance, and the adviser can live under his responsibility—and we think advisers should take responsibility for their advice, so there is a change there in that respect. While we agree that that is the way it goes, we are trying to work out the best arrangements between us. There are some principals who are absolutely

very good at it and there are some principals who are not very good at it. The ASIC rules on how to be a principal are still being worked out. No. 136 is coming, but they are reworking it. So there is a whole regime of competencies here involved in what the dealer does and what the adviser does, and that is in there. It is hardly legislation, but ASIC is working on that as a separate issue.

CHAIR—The dealer does not deal directly with the customer?

Mr Hibberd—No, not at all.

Mr Mitchell—He is not allowed to; he cannot deal with the customer.

CHAIR—Can you give me an example of a firm that is a dealer? When you say they have a whole floor, they are obviously a large organisation.

Mr Hibberd—The large dealers are AMP, the Commonwealth Bank—which has now taken over Colonial—and AXA. There are 480 principal dealers registered to do the jobs, so there is the big end of town—

CHAIR—They are all product providers, too, aren't they?

Mr Mitchell—Yes, 90 per cent of dealers are owned by the life companies.

Mr Hibberd—Product providers. But their financial planning has to deal with the product provider as a supposedly separate issue. So some of them are product but many of them are not. There are many dealers who are two- and three-man principals and who are running three- and four-man adviser groups but who are not related to product providers.

Dr SOUTHCOTT—So all of the funds managers would be dealers?

Mr Hibberd—Not really. A large percentage of them are, but there are some that are still not. BT is not a dealer; it does not run a distribution line, but many of them do. We think about 80 per cent of them do.

CHAIR—You said earlier that this is a past issue and that this is the way the government has decided to go. But it seems to me just looking at it that it is inserting an extra layer of bureaucracy for no good reason.

Senator COONEY—It is to take up the responsibility.

Mr Hibberd—Yes, it is a consumer protection thing here. It is all in the Wallis inquiry. It decided, and the government decided to back it, that the Corporations Law would be the model for delivering advice.

Senator COONEY—It is interesting that the legislation adds that additional protective plank, if you like, and at the same time suggests that advisers should be denied the right to work, which is doubling up, isn't it? It says that the responsibility is now going to go to the dealer but,

nevertheless, even though you do not have the responsibility for the transaction, you are going to be punished for it.

Mr Hibberd—What happens is that the dealer is now responsible to say whether they can or cannot work. Under the old arrangement, it was the people I had my agency with. Now the dealer is totally responsible. As I said, we have had cases where one dealer actually changed his company and said, 'The company that holds our dealership is now not going to be this one; it's going to be that one,' and tried to move all his advisers from that company to that company for a month and a half and some people were just simply out of business. They could sell only risk products, could not sell superannuation and could not sell investment products because the company did not get it right. There is a whole story behind it.

We have other cases where the company representative decided that certain things that were said in hallways not too close from here were not accurate and just simply pulled people's proper authority out. They just simply sat at the desk and said, 'Full stop.' The problem with that is that you cannot work. They could sell risk products but, when we go to the FSRB, that will control everything, so if a dealer comes along and says, 'I don't like the colour of your tie; you are out of business', you are out of business. Even worse, the current draft legislation says that the banning provisions that ASIC can bring in are such that they will be able to ban you first and then they give you a hearing. Under the new model FRSB it says that ASIC can ban you without a hearing; under the old Corporations Law they had to give you a hearing first.

Senator COONEY—Do you reckon it is a bit like the 50-metre rule? If you get reported you get 50 metres, even though later on you are acquitted.

Mr Hibberd—I think they are blowing the whistle and moving you forward without any discussion with the captain—that is the problem.

Senator COONEY—Yes. I find that very interesting. You quote Ross Freeman from Minter Ellison. What is the significance of that? Is that just the general current of feeling around the place, or is there some significance to that? That is on page 2 of the submission.

Mr Hibberd—The answer to that is that the Treasury people who put the draft legislation together have said that that was a mistake. In other words, it was supposed to be, as it is now: 'We'll give you a hearing first, then we'll ban you.' What Mr Freeman pointed out is that they changed it, and we will not see it until the bill comes into the House. We are simply saying, on the right to work, that you are innocent until proven guilty, not guilty until proven innocent.

Senator COONEY—Your understanding is that the Alice in Wonderland system, if I could call it that, operates—that you do the execution and then the trial. Is that still the situation?

Mr Hibberd—No. The current situation is that if ASIC wants to ban me they have to give me notice, as I understand it, and they have to run a hearing.

CHAIR—This is under the existing law?

Mr Hibberd—Under existing rules, I am sorry.

Senator COONEY—Under the existing draft legislation.

Mr Hibberd—The draft legislation simply says that we will ban you first and then we will give you a hearing. I do not have the draft legislation but it is very complicated, and we are worried that people will be put out of business incorrectly. We agree that advisers should be banned if they are not doing the job. As I said, our association has spent 43 years trying to regulate advisers and make the system more consumer friendly. We have a longstanding policy on that. We agree that, if advisers do the job wrongly, they need to be discouraged from being in the business—that is, take their authority away. But we do think that the system ought to have the provisions that apply in law now, which is that they are innocent until proven guilty.

Senator COONEY—What you fear is that, as the thinking is now, it will be the ban first and the hearing later.

Mr Hibberd—Yes, and we do not think that is good.

CHAIR—You have had discussions with Treasury on this, though?

Mr Hibberd—They said it was a mistake. The reason we bring it up with you people and in our submissions is to make sure it gets changed. It is as simple as that.

CHAIR—Given that comment from Treasury, you are expecting that it will be changed in the final legislation?

Mr Hibberd—The answer is: until I see the legislation, I have no idea. We have watched these things for a long time, and until I see chapter, verse and section—whatever it is—I have no idea.

Mr Mitchell—Chair, can I go back to something that you said in terms of imposing the dealer in between. Some information came out in the last month where Paul Bean, the Chairman of the Financial Industry Complaints Service—he runs the complaints service for life insurance, investment and so on—said that, because of the code of practice under the Agent and Brokers Act, which was brought in in 1973, misrepresentation has fallen from 37 per cent to 16 per cent on the life side. In the type of area we are going into, the Corporations Law, misrepresentation over the last three years has actually risen from 40 per cent to 45 per cent. So it is interesting that somebody came along and found something that worked, and it is working very well in the life industry. There are still problems but they are a lot fewer than they were. The problems have now shifted to where we are going into the Corporations Law—and there should be a story there. We decided that we would accept the decision of the Wallis inquiry, and we have done that. Nevertheless, this sort of information creates doubts—or it should create doubts in people's minds—that it might be the best way to go.

CHAIR—Was consumer protection the rationale for the Wallis recommendations?

Mr Hibberd—Absolutely.

CHAIR—No other submission was?

Mr Hibberd—If you read the Wallis inquiry report—and I have sat down with the people in Block B who put it together over the time—you will see they want to protect consumers. That is the minister's point. We agree that consumer should be protected. Our problem is that we want consumers to be able to make an informed choice with decent information and we want the level playing field to be there. The problem we have is that, in some respects, nobody really asked the consumers. So what we are doing is providing financial advice and financial plans to consumers but, unfortunately, they are still not reading enough of them. We have actually watched this and said, 'You have to do a customer advice record or a financial plan,' and we know for a fact that consumers are not yet reading these five-page or 40-page plans, even though it is their right. So what we as a government or as an industry need to do is encourage the consumers to be more alert, because it is their money that we are talking about and their financial advice problems, not ours. We need to encourage the consumer to be more relevant and to take notice of this. If we can do that collectively, then that will be a great outcome. I think that was the tenor of Wallis was—let us have an informed consumer make an informed choice.

CHAIR—Does the issue of alienation of personal income legislation arise out of this change in the position of the dealer?

Mr Mitchell—Yes, it does; that is right. What is happening now with the multiagents is that there are five cheques coming in every month, whereas with the dealer there is one cheque coming in, so it will catch more people. There are a lot of other rules there and it is going to affect only a few members, nevertheless it is still doing that.

CHAIR—Whereas, in effect, you are still working with those five?

Mr Mitchell—Yes, that is right.

CHAIR—But it has fanned in and then fanned out again.

Mr Mitchell—That is exactly right.

Mr Hibberd—The interesting thing is that we are still doing the same job. Whatever happens with FSRB, all the people around here that are involved will still be doing the same job. Different set of rules—fine—but let us keep doing the work. If you look at the government's position on superannuation choice, which is a very important issue, you will see we agree on superannuation. But we have not got enough people to deliver advice on superannuation insurance available in this country currently, with only 14,000 advisers. Anything that stops us from doing our job of protecting Australians and building their wealth has enormous consequences for the public policy of whatever government. Alienation of income affects how strong our businesses are and, if our businesses are not strong, therefore our industry is not going to be strong and we will not be able to advise people.

CHAIR—Wouldn't your members meet the other tests that apply, though?

Mr Hibberd—The point was made last week by one of the major life companies which said that 40 per cent of its advisers work in regional officers, a large proportion of them work at their home office and they will be affected by alienation of income. People have company

constituents, they have an office in the back of their house or in the front of their house—as my friend sitting next to me has—and straight away they are doing the same job, doing a great job out there in regional Australia. So one large institution has 40 per cent of its agents or advisers out there; I do not know how many will be affected, but there will be a large percentage of people who will be affected by it. We think that is not appropriate, to put it mildly.

CHAIR—As there are no other questions, we thank you, Mr Hibberd, and your colleagues for your evidence before the committee.

Mr Hibberd—Thank you for your time. We appreciate it.

[12.10 p.m.]

FOSTER, Mr Darryl Robert, Director, Life Agents Action Group

MAUGHAN, Mr Paul William, Director, Life Agents Action Group

VEIVERS, Mr Greg, Director, Life Agents Action Group

CHAIR—Welcome. We have before us your submission which we have numbered as No. 1. Do you wish to make an opening statement before we proceed to questions?

Mr Maughan—Yes. Thank you, fellow workers, for this opportunity to address you this morning. We are a political lobby group representing some 3,000 life agents across Australia who are predominantly multiagents; that is, they represent more than one company. No-one has a more vested interest in the FSRB than us because we are the end users; we are Australian small business.

While we recognise there are many issues with the FSRB, we wish to address only two issues today. The first is commission disclosure on risk business; that is, insurance products that do not have any investment or saving contents. In other words, we are going to be talking about term life, income protection and trauma insurance. That is what we are addressing when we say 'risk'. The other issue we wish to address is training and competencies under IPS146.

I will lead into the debate on the issue of commission disclosure and then my colleague Darryl Foster will talk about IPS146. To start with, we come from the position that commission disclosure serves no benefit—full stop, the end. The issue was buried and defeated prior to the code of practice in 1996 but subsequently resurrected itself as an issue out of Minister Hockey's office. But, at a task force meeting in Canberra in May 1999, all parties at the table agreed that there would be no commission disclosure on risk business—again, that was decided— and there would be commission disclosure on investments and savings products if the consumer specifically requested it. Outside of that, it was over, dead, gone. So here we are again discussing this issue as it seems to be in the proposed legislation.

Consumer groups are driving commission disclosure but have never tabled any hard evidence of genuine consumer concern. We see no evidence of it at the coalface. Our opponents claim that we agents are commission driven in our client dealings and so, therefore, we have a vested interest in product recommendation. To the uninformed that might seem so—and as small business operators we do have an interest in profit—but we contend that the commission content of a risk sale has no impact on the claim payment or policy benefits. So there is no real purpose in commission disclosure, other than as an unpalatable intrusion in client-agent relationships. It is further claimed that agent misrepresentation is a major industry problem, and that commission disclosure will rectify this matter. Again, this is a fallacy, and there is no empirical evidence of this. In our earlier submission to your committee we tabled figures that showed industry statistics of a decline in agent misrepresentation coming down from 1994 to 1998. The number of these agent misrepresentation claims were absolutely negligible anyway, but we now have further statistics to present to you, which we said we would, that relate to the

year ending 1999 and show a further decline. I will hand these statistics across the table to committee members and we could perhaps look at these now.

On the very first page when we open up addendum No. 2, we have an overview of the industry's statistics. That shows, as we said earlier, that the complaints were declining through 1994 to 1999—dropping from 1,260 down 798. Of these, the standard of service in the life insurance industry from the life companies was the second highest form of complaint. When we look at the situation as it relates to misrepresentation, you will see at the bottom of the page that it was 16 per cent in 1999. That represents only 129 complaints of misrepresentation across risk, investment and superannuation products. That represents less than one per cent. That is an incredibly small rate of misrepresentation. If we flip over the page, we come to one company—Australian Casualty and Life. The reason we picked this particular company is that it has the largest market share of risk business in Australia—risk business as in life assurance, income protection and trauma—and it is a company that does not sell any investment product at all. It sells nothing but risk. When we look at their situation, we see that their number of complaints on agent misrepresentation for the year 1999 was one. The number of new policies they brought in that year was 25,998—nearly 26,000 cases. So one case as a percentage of that is 0.004 per cent. The problem does not exist. If you take it down to total policies in force, it is even higher again. If we go to the next page, we see risk policies in force, which represents all risk policies from all life companies in Australia. Under 'income protection' there are approximately 700,000 income protection policies and under 'life and trauma insurance' there are approximately 2.3 million policies, which total three million policies. We stated earlier that the misrepresentations for the year were 129 cases. They include both investment and risk. The percentage shown is 0.004 per cent. We contend that there is no problem.

Senator GIBSON—Of that 129, do you know how many are risk and how many are investment? Are they mixed up?

Mr Foster—It is not stated in the FICS reports—the Financial Industry Complaint Service reports. We only know of the portions of some companies that write risk.

Mr Maughan—I will just move on from those statistics for a moment. It is also inferred that commission disclosure is required to show agent bias for a particular company or product line. We have had this argument put to us. Agent preference for a particular company or product is certainly a real and everyday issue; however, it has little to do with remuneration rates. It is more a matter of service and relationships that we have with companies. I will use myself as an example. I represent two companies. Both of those companies are not regarded as high remunerators. The reason I deal with them is that they are easy to do business with—they let me get about my business. If I wanted to make more money I could certainly go to other insurers who would pay a higher commission, but I choose to use these people because they are easy to do business with. I would contend that that would be so across the industry.

Before I close on the commission disclosure issue, I am happy to take any questions. We do want to touch on the point of the level playing field, which was brought up by our colleagues just previously. In our industry we currently have commissioned insurance agents and salaried officers selling the same product. In the proposed legislation the commissioned agent is required to disclose earnings, for the reasons mentioned already, while the salaried officer is exempt, other than stating salary. As our colleague said, the salaried officers are on quota systems. They

get bonuses and those sorts of things. We feel this is terribly unfair. We would suggest you should not play off that. We are suggesting that you just get rid of commission disclosure full stop. It is not needed. That would get rid of this problem. We also propose that industry funds should be caught by this legislation so that we do not have the ludicrous situation where we have high-profile people like Bernie Fraser explaining the virtues of his no-commission products over those of commissioned agents, even though these products are on a commission basis. We have here an article to present to you on that issue. I am sure you are probably already aware of the results of those hearings, but we are happy to table that to you in due course. We would be happy to take questions now on commission disclosure if the committee has any, and after that my colleague Darryl can address the training and competencies issues.

CHAIR—From what we have heard, the arguments you have put are pretty similar to the Association of Financial Advisers. Is that a fair comment in terms of the summary of the points you have made? Are there any areas of difference between you and the Association of Financial Advisers?

Mr Maughan—On commission disclosure on risk I would think they would have the same stance as us. They would probably prefer that it was not there at all. That is the message I hear coming from them. That has been the message coming from everyone since 1996. The issue just keeps rising. We do not know why we are sitting here fighting.

Mr Foster—At the current time under the life code of practice we present to our customers on the basis that what products we are licensed and competent for we receive remuneration by commission. If consumers want to know how much commission is earned, they already have the right under the Insurance (Agents and Brokers) Act to ask. That is what was agreed last year when we sat at a hearing for the freedom of choice super—that the consumer had the right to ask. It becomes too involved when you have got to disclose each amount, from bonuses to base commission or if your sales quotas are through banks or soft dollar options, or whatever else. It would be a huge document to disclose to the consumer and, quite frankly, most consumers do not read them. As the representatives from the Association of Financial Advisers said, I doubt very much whether any consumer ever reads the customer advice record, which is attached to each sale that goes to the life office and which is forwarded on to the consumer. In fact, most life officers do not read them either.

Mr Vievers—Also, depending on the company or the products you use, our business is a little different from a lot of others inasmuch as some of them have a responsibility period of one, two or three years. What do we do then if the customer changes his mind 18 months down the track and we forfeit all the commission that was paid to us? Does that get highlighted in the marketplace? We finish up with nothing after doing all the correct work in setting a proper business in place for the right reason, which we feel in some instances is wrong when you have banks out there simply policy pedalling. I want to put this on record: a colleague of mine is actually the principal of the life arm of one of the big four pillars. I was trying to get him on board to support us in our cause but he said they were not interested. Their view is that the role of their so-called reps or employed staff, or whatever they choose to call them, who sit in the corner on a stool—they do not give them offices, because I do not think they do not last that long—is to ‘rock out four policies a week out of every one’. That is exactly what he said. I thought to myself, ‘That’s a bit hot.’

One of my relatives happens to work in a bank, or he did more recently, and the pressures that are now being brought to bear on young staff members to produce appointments for the bloke who sits in the corner are over the top. The bank manager gets a few ticks and a few dollars at the end of the day for meeting a criteria, but these poor kids who are tellers have to get granny who comes in to put her two-bob into the bank to go over and see Bill Smith in the corner because he has a good deal lined up for her. It is just a numbers game. We are not really dealing with people who are in this profession—I have done 30 years in this business and I really enjoy it. I think we offer a lot to people out there but we keep getting caned, for what reason I do not know. The catchcry for a long period of time has been that misrepresentation is the way to get us. I do not know how they are going to get us. In Queensland we have a police force overseeing the police force and they cannot get it right. We have a figure of under one per cent for misrepresentation by agents. And we are talking about an agency force that is starting to diminish. You will find that a lot of these people are middle-aged. They are not bringing too many young folk into the marketplace anymore. If it gets too tough for me I am out. I am just sick of all the hoo-ha, and I have a lot of colleagues who are in the same boat. We have fought this fight for a long period of time. There is just no point. If you keep getting belted across the forehead with a piece of four-by-two, at some stage—

Mr Maughan—He has been belted a few times.

Mr Veivers—you just have to say to yourself, 'This is just too tough; I'll just go somewhere else.' I do enjoy the business, as do all my colleagues, but I think we are barking up the wrong tree here. If we are going to have a fair playing field, I think that banks and anyone else who wants to sell our product—the only purpose for their selling the product is that the margin and the technology have moved from the banks to us, and their profit margins have gone belly-up so they are after every opportunity. We are simply out there to do the right thing.

Mr Foster—To highlight Greg's point to some extent, I think the commission is not a criteria—although it is in some respects. If the commission is not a criteria and you come across a product that is paying 20 per cent and one that is paying 25 per cent, the benefits of the 25 per cent product could be inferior to the benefits of the one that has 20 per cent. You have to look at the total benefits of the policy, not the commission. If you are commission driven in our business you will go broke. It is benefit driven to your client, because if you do the wrong thing by your client you will not have him long term.

Mr Maughan—When we say we want to eliminate commission disclosure and risk out of the equation I think the key issue is that, from the consumers' point of view, when they are buying our products, it is a low-involvement decision. It is a high-involvement decision for things like real estate, but we are talking low-involvement decisions here. No-one asks. We have said all along that we would be very happy to disclose our commission if a client asks. I have been in the industry for 35 years and no-one has ever asked me what my commission is, ever. No-one is interested; they just want to know what sort of services I deliver. If they ask the reality is that I have to tell them, whether there is commission disclosure or not, and I would. It is just not an issue. It is an issue for the consumer movement that is driving this, but it is certainly not an issue from the consumer, the true consumer.

Mr Foster—The end benefit does not affect the return to the client. If he has a half a million dollar trauma policy or a $5,000 disability policy, what is in the contract is what he has paid.

Senator COONEY—Do you sell third party insurance?

Mr Foster—No, that is a general insurance operation.

Mr Maughan—We only sell life products, term income protection and trauma.

Senator GIBSON—The differentiation for your members' income between risk products and investment products basically has not changed. Twenty years ago you were largely driven by life insurance—if you like, risk products.

Mr Maughan—I have always been largely driven by my wife.

Senator GIBSON—But, today, what proportion of your members' income would derive from the risk product as opposed to the investment product?

Mr Maughan—I would suggest it would be at least 50 per cent, if not greater. Since we have had commission disclosure on investment products, the commissions have declined. It has now become too difficult to service it so most people have retreated from that arena and put more concentration onto risk product. It is a very real earning capacity. It would have devastating effects on members' incomes.

Senator GIBSON—At the same time as there has been a backing away, if you like, from the investment product, has there been growth in the risk product area as far as your members are concerned? Has there been growth in the Australian market?

Mr Foster—Since 1996 with the introduction of the Life Insurance Code of Practice which brought in client needs and certain rules, risk product has gone up by four times. Previously the market was underserviced. Most people prior to that probably were selling some investment related product with a small portion of risk. Now they go in and review the risk on the total needs of the customer and the true sums insured, which gives you a greater premium.

Mr Veivers—It is fair to say that things have changed because you have got these great redundancies and great pools of dollars from people who have saved over a long period of time. That is probably what we did 30 years ago: put people into passive saving, which is probably the only hope for 95 per cent of our nation. But because you do not get paid—and I guess, if anything, you are paid properly to do your task here—you would not adhere to it as well.

Senator GIBSON—Sure, I understand.

Mr Veivers—But it is not being written out there at the moment; it is a crying shame that a regular investment product is not being written anymore.

Mr Maughan—Our colleagues alluded to it before: that market is not being serviced because the agency force is not paid to service it. It just remains out there; therefore, the government has to pick it up in social security benefits.

Senator GIBSON—But as against that the total amount invested in superannuation—managed investment and collective investment funds—continues to grow.

Mr Veivers—It does with your SGC. But they also take into account the moneys coming from old life policies and those sorts of things being reinvested and rolled over. We are crediting the same money twice, in some instances. I think that if people look at Bernie Fraser and think that, because there is no commission, there will be a retirement portfolio at the end of the day, there are going to be a few sad people out there. They are going to have to come and tap on the door in Canberra because it will not be sufficient to provide the requirement.

Mr Foster—To give an example, the Ernst & Young ABC kit 'The Facts of Life' gives the APRA life statistics as at June 1999. If you look at the graph at the bottom of the first page you will see that the annual premium in force in 1995 was $5½ billion. The annual premium now in force is between $15 billion and $20 billion. That relates to risk premiums. SGC contracts, such as your superannuation guarantee to all contracts, have only a minimal amount of risk. Depending on age, it is usually put between $20,000 and $50,000. There is no advice given on those sorts of products, it is just a bulk entry. If clients want advice they either increase that sum insured or, alternatively, they take advice on other products.

Senator COONEY—In your letter to Senator Chapman you said you have been to Mr Hockey and put in your complaint. He is in a party that is different from mine. You have been fairly candid about him in asking why the minister is so ignorant or so dismissive of industry opinion. Have you asked him?

Mr Maughan—He does not return our phone calls.

Senator COONEY—What about your letters? There must be something in the office.

Mr Foster—We have sent a couple of letters to Mr Hockey but he has referred us back to ASIC which will set the rules as part of the draft legislation. I attended a meeting last year on freedom of choice superannuation. The industry were involved and were in the room. Minister Hockey came in, slammed the desk and said, 'There's no negotiation.' He left the room and, when we left, we had negotiation. The problem is, I think, that he is being pushed by other people in the industry, by consumers or by somebody else. We can never get proof from the consumer movement as to why they want commission disclosure on risk. We have no objection to investment because it affects the end return to the client. But on risk there is no end return; you either get paid the money or you don't.

Senator COONEY—I am not calling into question in any way your good faith, but it seems strange that, given the very strong submissions you have made to the minister, you have not got an explanation. I am not talking about an explanation that you agree with, I am not even talking about an explanation that is right, but I would have thought there would be some explanation.

Mr Maughan—Originally it was reputed and you people have probably heard that there was a vendetta against life agents which came out of ISC's office. Most of those people have swapped over to ASIC now. We believe the vendetta is alive and well.

Senator COONEY—If everybody had to make a disclosure about the costs that are involved in running the business— whether it is run through the bank or through you—I know you would still have some objections, but would most of your objections go or would you still think that even though everybody has to make a disclosure that this is too much an intrusion on privacy?

Mr Maughan—I think our objections would still be there because you cannot get any honesty into the equation. There are so many variables in the commission content, and Greg mentioned before that there is even a claw-back of commissions if the case cancels. There are volume bonuses that go into it, depending on the work ethic of different people, so there are basic commission rates, volume bonuses and lapse rates. There is just no way you can get real honesty into it and it serves no purpose. It seems silly to fiddle with it. Why not eliminate it?

Senator COONEY—There is always the proposition, which has some merit, which says that where you are dealing with other people's money—and of course in government they talk about the taxpayers' money—it is only proper and right that there ought to be transparency, even though people might not resort to that transparency on a number of occasions. Do you have any case about that?

Mr Maughan—They are only buying a product. We are not investing their money or doing anything to their money. They are paying a premium for a risk. In other words, if they die this particular year, the insurance company will pay them, say, $100,000—there is the premium. That is as transparent as you can need it. At the end of the year, the contract is over—all finished.

Mr Foster—I think the transparency should be on advice about the actual benefits out of the product.

Senator COONEY—When you say there is nothing to it, on the pamphlets you have given us today, you list the number of companies involved. No doubt they are in competition with each other. Should a person who is going to purchase one of these products be able to see what is happening within the company as far as possible?

Mr Veivers—We all agree that since 1996—everyone has supported it and now we have run with it—disclosure of commission on investment products is alive and well and being handled very well by the consumer. He knows exactly the costs that are involved in that. I feel, as do all the other members, that buying a life insurance product, a trauma product, is no different from buying an apple, a can of coke or any other commodity down the road. If you do not like the price for the $100,000 required for the situation, then you go down the road and speak to one of my colleagues. The same sort of thing has to be required in benefits. If you walk into a bank, the bank says, 'We're going to lend you $500,000, but before we give you the money you've got to take a policy out with me to cover that debt.'

Senator COONEY—But with coke and a car, anything like that, you know what you are getting. If something happens to it, you can do something about it. With this you tend not to know what you are going to get until you die. Do you insure against injury as well?

Mr Veivers—Income protection, yes.

Senator COONEY—Often times you get your problem then. People say, 'Your policy didn't quite say that,' or, 'We're going to delay the payment of your return from this policy,' and what have you. In other words, there is the sale of the policy and there are also the problems that arise when the policy comes to maturity or when you want to collect under the policy.

Mr Maughan—There is no collection under these policies. They just pay purely on the event, on the happening—death, disability, injury. There is no money back and no investments.

Senator COONEY—I always understood that somebody is going to get a payment. What I am saying to you is that it is the way that money is paid: whether it is going to be delayed, whether there are going to be hassles or whether it is going to go to court and be disputed. You say it comes back, and I have known of court cases to deal with assurance companies, as they are called. In fact, I have known of cases to deal with all sorts of insurance over the years and my experience says that seems to be the test. What happens when you come to claim on it?

Mr Veivers—No different from the three claims that my folks have had on their car insurance because they are elderly.

Senator COONEY—That is a bit different.

Mr Veivers—The content on the car insurance policy is no different from the content on a life policy. It is simply up to the insurer as to how they perceive it at the end of the day. It has nothing to do with how it is sold up-front, other than the benefits. I listened intently before when the fellow was talking about his car insurance. They ring up and get a car insurance price, pay the premium and the deal is over. In our particular instance, for someone to come in and purchase a product, we have to do a detailed fact find, find out a bit more about the individual's wares, family, commitments and needs. We explain the policies far more succinctly than any of those general products that you were talking about. Our business is referral based predominantly, and that is how we travel. If we do the right thing, you get a lot of business. With car insurance, if it is too dear today, tomorrow they will go somewhere else down the road. Life insurance is no different, except that we are giving these people substantially more information to make a proper and informed decision.

CHAIR—The issue that Senator Cooney is raising is about some sort of dispute arising at the time of pay-out. Is that going to be affected by whether or not commissions are disclosed when the product is sold?

Mr Maughan—That is all to do with definitions and the way the companies work. I would suggest if you had one of the people in this room either sitting at this table or behind me you probably would not have too many problems because our business is all about relationships with people. We would be going out of our way to make sure that that claim was settled as quickly as possible. It does come back down to the basic policy definition. It has nothing to do with what is paid up-front.

Mr Foster—Probably a good example is if I went to the National Bank and they had their own life licence and their own branded risk product but do not sell any other outside product.

Senator COONEY—Yes, but you are not answering my question, which worries me a bit. You do not seem to be addressing it and I am wondering, from Mr Hockey's point of view, what is going to happen? Why should not people know what is being taken out of the system by way of commission, or what have you, to assess what sort of reaction is going to happen when he or she comes to collect on the policy? You say it is irrelevant, but that could be seen as a self-serving statement.

Mr Veivers—Because we do not have any involvement at the other end.

Senator COONEY—Exactly. You are selling something with which you have no involvement at the other end. That is where these problems arise because the person who actually sells the problem is not the person who is going to deal with the problem later down the line.

Mr Maughan—How does commission disclosure assist with that?

Senator COONEY—It will give you the sort of thing so that you could say, 'What is this company about? Is it interested simply in paying high commissions to get salesmen to sell this policy or is it interested in getting a product which was going to give somebody a result down the line?' I can understand—I think—why Mr Hockey takes the approach he does. That is all I am saying.

Mr Maughan—I would answer that question by saying that all I could state is simply what the client might expect from the company on my experience currently, but as the event might be five, 10, 15, 20 or 30 years off—a death of disability way down the track—it would depend very much on what that company's philosophy and direction was at that time. Again, I would come back and say that it has no bearing on what commission I have been paid.

Senator COONEY—You say that. It amazes me that you say you have no understanding at all of why Mr Hockey takes the approach he does. I am just trying to think of reasons why he might. I might be completely wrong about that, but he always seems to me to be a very responsible sort of a minister.

Mr Foster—We have written to him on a number of occasions and we seem to get the short reply.

Mr Veivers—If it is to do with us again, we are talking about misrepresentation, and that is basically what we are saying. We should go to the history of the misrepresentation, how it has come to pass over the last few years when we have been monitoring it really very closely—it is less than 0.4 per cent. The other thing too is that the number of cheques that we taken out to widows and those sorts of people at the point of claim, and made sure they all go through, is out of this world. No-one understands that. We are all worried about ourselves being misrepresented to the task force up front. I do not know how much we can prove to everybody else that the misrepresentation out there is not being compiled by anybody in our organisation; it is all done independently. My 30 years have been pretty much that, as have been my colleagues, probably. I cannot believe that there is a correlation between what happens with a claims department out there, other than, if we look through the statistics here, the life officers who are the

predominance of problems as it stands at the moment, not the agents. We feel there should be some sort of regulatory problem solving put in there.

Senator COONEY—Perhaps we could ask Mr Hockey. Misrepresentation might not be the issue at all. We do not know. Perhaps we should ask.

Mr Foster—I believe customer service is a major service in our industry. Even now with the government changing the rules on how life officers actually account to their shareholders or their balance sheets, the thing that gets affected is customer service, because they have to pay extra dividends or find extra money to pay their shareholders. As the FICS report says, 38 per cent of the complaints are about customer service. If you look at some of the internal life officer complaints, it is over 60 per cent.

Mr Maughan—Could we address IPS 146 now, if there are no other questions? My colleague, Darryl, is going to make some statements.

Mr Foster—One of the things that came out in CLERP was that in training and competencies the rules were not defined. ASIC introduced IPS 146 in October 1999 with a two-year transition period. One of the problems we have is that this clock has been ticking for almost a year now, but no training and competencies have actually been judged since that time and CLERP obviously has been delayed. As the AFA said, the life insurance industry is a very old industry and the general insurance industry is the same—it goes back 70, 80 or 100 years. The problem with IPS 146 is that it actually said that your competency and training had to be done in the last 10 years. In our industry, to take myself as an example, I have done an associate institute of insurance in the 1960s, I have done courses in the 1970s and the 1980s. The financial planning industry is only a new industry which commenced in about 1987 where all the training has come from in the past.

The problem with IPS 146 is that it does not address the old part of the industry. It is now saying that you have to be retrained. In these statistics, I have said that 50- to 60-year-olds are 44 per cent are our membership, 40- to 50-year-olds are 35 per cent and 25- to 40-year-olds are 18 per cent—and it is no different in the industry. The problem we have is that 80 per cent of our industry now has to be retrained. I do not know of any other occupation—doctors or lawyers—where you are not going to take into account any past experience and all of a sudden start again. I run a dealer group of over 300 people. If those rules do come in, I expect that 40 per cent will disappear over night. They are too old and will retire, and we are bringing new people into the industry. The selection we put forward in our submission was not so much grandfathering, but taking into account the experience that those people have had when they come to do the competencies. The life insurance code of practice has been in since 1966—it was related by Dugald Mitchell. Part of it says:

In 1993, misrepresentation advice related to complaints was 37 per cent. In 1999, it was 16 per cent.

Mr Bean, who is chairman of the Financial Industry Complaints Service, said:

I believe that the code of practice has brought about change in the life industry by stringent guidelines as to the training and competency of intermediaries.

This addressed the product competencies and the basic competencies, but it also addressed their past experience when they had their agency agreements. I feel we are going to have a very large exodus of our members if that does not take into account those past experiences.

Senator GIBSON—Have you given those views to ASIC?

Mr Foster—We have written to ASIC, yes.

Senator GIBSON—Have you had a response?

Mr Foster—No.

Senator GIBSON—How long ago was that?

Mr Foster—Three months ago. With IPS 146, with the clock ticking, everyone is coming out and saying they are going to register training courses and you have to do these courses, but people are saying, 'Why should I do them?' They really do not have to because the transition period should be put back into CLERP, but the bottom line is they already have some training in competencies. We need updating maybe, but not brand new courses or legislation.

Senator GIBSON—Is that the essence of what you have suggested to ASIC?

Mr Foster—Yes.

Senator GIBSON—Perhaps you should send us a copy of that submission.

CHAIR—When I asked ASIC about this, the chairman said that no policy statements would be issued that are incongruent with industry codes. I am wondering would the best approach be to negotiate the training requirements with ASIC or do you want it written prescriptively into the legislation?

Mr Foster—I want it left to the industry to make that code, not so much to have ASIC control it. I think it would be better for the life industry to decide on that code. We have a life code of practice that worked very well for the past four years—you can see by the statistics. Why change something that is working? The investment side has been fairly well controlled through the Corporations Law and they have already done that training competency over the last 10 years, being new to the field. I fear you are going to have a downturn in people on the basis that they are not prepared to do this new training. If I were 58 years old and wanted a change of career, I really would not want to go back to studying.

Mr Maughan—We have real statistics here, as Darryl is referring to. I am one of those in that bottom group. I am 55 and certainly, if I have to go back and do more studies, I will just retire, full stop. I did my diploma, which was regarded as the pinnacle of product knowledge in insurance back in 1973. It took me four years to do that course. I am proud of my results and now it stands for nothing. In fact, my 35-odd years apprenticeship stands for nothing and here we go again. I think it is a bit of a tough call. I could not imagine asking doctors to go back and

resubmit themselves after all this time. It just seems ludicrous. Most of my colleagues agree that basically we would look at retirement and it would leave a heck of a hole.

Senator COONEY—You have figures in the booklet you have given us. Addendum 2 is taken from the Life Insurance Complaints Services Limited. Are the industry statistics from the same source?

Mr Foster—That is the Financial Industry Complaints Service run by the financial services industry. They are the figures off their report. If you look at the second, third or fourth pages, they are the relevant pages of a particular life office and the industry complaints which back up those reports.

Mr Maughan—We have extrapolated them out so that you could read them a bit easier.

Senator COONEY—And the overall policies come from the same source?

Mr Foster—Yes. Actually how it eventuated was that we took the premiums by the average premium in force and multiplied it out.

Senator COONEY—Does that chart appear in the—

Mr Foster—No, not in those front complaints. But if you take the reports from 'The facts of life', statistics of income insurance, which shows the volume which is in the industry, we have made some phone calls around to various life offices, found out the average premium in force and then multiplied it out to come to those statistics. That is why on the front it says 'approximately'—it could be a hundred thousand out.

Senator COONEY—And the nature of complaints report is from the same—

Mr Foster—That is from FICS. They are exact copies from that article.

Senator COONEY—And 'The facts of life' you have?

Mr Foster—That is a much larger report. We have only taken out the sections that are relevant to our cause.

Senator COONEY—That is Ernst & Young?

Mr Foster—Yes.

Mr Maughan—We would conclude by saying that we see the industry being best served by having no disclosure on product commission and we also ask that the industry be better served by leaving the senior people in the industry alone and letting them get on with their jobs. They have done a pretty good job for the last century. Thank you very much.

CHAIR—Thank you very much for appearing before the committee.

Proceedings suspended from 12.54 p.m. to 1.52 p.m.

LARKEY, Mr James Victor, Executive Director, Australian Association of Permanent Building Societies

VENGA, Mr Raj Ashwinn, Director, Policy and Compliance, Australian Association of Permanent Building Societies

CHAIR—I welcome the representatives of the Australian Association of Permanent Building Societies. We have before us your submission, which we have numbered 9. Do you wish to make an opening statement to introduce that submission before we proceed to questions?

Mr Larkey—I think so, if you are amenable to that. There are 19 building societies around Australia now. As I said before we started, they are all doing reasonably well. I think the interesting thing for you to keep in mind when looking at this proposed legislation is that these societies transact their business through over 1,000 branches or agencies. Of the 1,120 outlets, about 750 of them are agency arrangements. The assets of the societies are $13 billion, so collectively they are the size of a middle sized bank, I suppose, in the Australian scene. Nevertheless, the building societies are what you might call the small businesses of the finance industry. Let us face that fact. Some of them are quite substantial but they are small in the totality of certainly the big four and certainly the big 10, I suppose.

Their main business is deposit taking and making loans—predominantly housing loans. Eighty per cent of our assets are in loans for housing purposes. You probably knew that; nevertheless, it is nice to restate it. It is a fairly simple operation by most measures in the finance industry today. Nevertheless, the societies are heavily into transaction services, which, again, are relevant to this bill. In other words, we provide non cash transaction services, and in that area we are a significant competitor even though we are small businesses, if you like. We are significant players because we tend to, at the margin, provide some competitive pressure in the marketplace. We are significant recipients of social security payments on behalf of our members.

We take more than our market share. Some analysts think that is not very good policy, others think it is a good idea, those who are more socially inclined commentators, but the financial analysts do not think much of it. Fortunately, we are not driven entirely by what the financial analysts have to say, but we are nevertheless very conscious of our costs. That is one of the prime reasons we are appearing before the committee.

The industry has been through some very significant changes as a result of changes in legislation and changes in market forces, but particularly we have recently transferred to the Banking Act and under the Corporations Law, so the societies are now subject to the Banking Act and our incorporation comes under the legislation that you people review from time to time, whereas previously we were under a state-based law. That has been fairly smooth. It was a consequence of the inquiry but it has, as you imagined, raised quite a large administrative burden for the societies. When one adds that to the general impost of compliance, which has been a feature of governments in the last five or six years, I guess one has to say there is a feeling amongst the directors and the senior managers of building societies that they are, as it were, being imposed upon by one agency or another to do something or another for them,

including telling them how to do their business. There is a level of concern, particularly when the pressure is on margins in a very competitive business, to look critically at any bright idea that may come from, dare I say it, a member of parliament, a member of the bureaucracy or the regulatory authorities, and that is as it should be, I guess.

CLERP 6 then I have to say has been examined by all directors of all societies. We have had plenty of time to look at it and there is a general expression of disagreement with the direction which the government has decided to move in relation to CLERP 6. We have made representations on about four occasions whilst this process has been in place, so we have not just come to this at the last moment with our views. Our views have been made known to the Treasury officers and to the ministers over a long period of time. I think we would have to say that we have not had much success in convincing people that they might be on the wrong track. As I said earlier, the main reason for concern is the basis of additional costs which will be imposed on us and the effect this may have on the efficiency of our operations. In a sense there is a lot of what is in this legislation being put into black letter law, which makes it a little harder to do the business that you are probably doing anyway. The societies, along with banks, in terms of the banking business that we do are virtually in a no-risk business. The products we offer are no risk. It is high volume business, it is low cost and it is service orientated. In that process you are dealing with a lot of people, getting them through quickly, providing a simple product which even the most ignorant person has a good grasp of–namely, a deposit, a transaction account and so on.

So we were somewhat, and we participated quite significantly in the inquiry, surprised that deposits and non-cash payments were included in the financial products areas. Essentially, our main case is to advocate a review of that. I know it is in the definition of the inquiry, they did include deposits, but if you read in the inquiry I do not think they were entirely committed to it with the enthusiasm which has become apparent since from ASIC. So when ASIC commenced to take initiatives in this area in other areas, but which were anticipating that deposits would be part of the system, there was concern. We do not have any difficulty, and we could understand the need for a single regulatory authority in the area where superannuation and retirement, financial planning, financial advisers, what we call that end of the market, which is complex, which is difficult and where people do need some advice. Indeed, it has got to the situation where the average person really is hard pressed to do anything in retirement or prepare for retirement unless he gets advice. So that is a different business to our main business. So, to give you a setting, the building societies do not see any demonstrated need for the proposed regulation on the retail banking products that we have.

We raised a number of issues with the committee, but specifically there are three items. The first issue we raised was the issue of the inclusion in the system of deposit products and transaction accounts for non-cash payments. The second point was that the definition of ‘financial product advice’ is too broad and indiscriminate. The third issue was with respect to agents. I mentioned that 66 per cent of our distribution is through agents. These days most of the building societies are in what you would call regional towns. I know the government is sensitive to providing services to people where there is not a full branch, and we do use agency arrangements. Under this proposed bill, the requirement for agents to be appointed as authorised representatives by the societies because these agents will provide financial services within the meaning of the bill presents obvious problems. Many times agents will be people who run a pharmacy, a newsagency or something. Basically they take deposits, arrange for cheques and fill

in forms. We would not have thought that that ought to be subject to all the paraphernalia which is anticipated in this legislation. It will make those agencies marginal, frankly. So we have drawn the attention of the Treasury and anyone else who is interested in this matter to the impact on agency arrangements. There are people other than ourselves who have an interest in that, including the government itself with its rural transaction organisations. So they are the three points that we are on about—deposit products, the definition of financial product advice and the impact of both of those on agency arrangements.

I probably do not need to go into it any further, although I am quite happy to do so if you wish. We can explain our interpretation and understanding of the bill and why we feel like we do, but maybe I have already conveyed that. Raj Venga has been at a lot of meetings, and this has been raised not only by us but also by the banks and the credit unions. When you come to meet them I am sure you will hear a similar story. We have not made any progress with the Treasury. I would not want to prejudge them, but I do not think we have even had the benefit of a sympathetic ear. We constantly look at the practical realities. So the customer comes in and you give them a piece of paper and it says all these things and then you give them another piece of paper, but the reality is that, with respect to the product that we deal with, they do get material and it is subject to the codes of conduct which we all have.

Under this bill the codes of conduct which were voluntary—under a lot of suasion, but they were voluntary—are virtually becoming written up in a piece of legislation. So what was voluntary five or six years ago, or when the banks were forced to have a code of conduct—and because they were forced we all had to follow even though we did not have systemic problem—has become compulsory under this legislation. The idea of creeping legislation in a so-called deregulatory environment has, I think, a few legs, particularly as it applies to our products. We are looking at it from a practical point of view and, for the life of us, we cannot really see why many of our simple core products need to be included in what we acknowledge to be a fairly complex area needing regulation to ensure the best possible independent advice which people should be getting. That is our story.

CHAIR—You have highlighted your view that the definition of financial product is too wide. In that regard, are you really reflecting the same position that the banks and some other organisations have? Is your particular concern the requirement that would be imposed to train counter staff up to the status of advisers and also the fact that you have to do a statement of advice?

Mr Larkey—Yes.

Mr Venga—It is a bit blurred as to what constitutes personal advice. Take a situation, for example, where a customer comes up to a teller or to the counter staff saying, 'I need the following things. Do you have a product that suits?' All the teller does is take out a brochure and say, 'These things seem to be covered here. This is probably what you need.' Would that be personal advice? I think it would be. To have average tellers and counter staff being trained to a level expected by interim policy statement 146 from ASIC is a big ask. When you translate that into an agency situation, where you are talking about pharmacies and newsagents who have their own business to contend with, to then have to be supervised and trained to that level is quite ridiculous. We cannot see this working, to be honest.

CHAIR—Have you made any estimate of the cost to building societies of complying?

Mr Larkey—No, not really; we have not.

Mr Venga—We have been told by at least one building society that it would not take the business risk of having agencies if this legislation were to go forward.

Mr Larkey—On Friday at our executive meeting—and Mark Scanlon from the Bass and Equitable Building Society is on our executive—we discussed this, as we had set this meeting with the group. In Tasmania he has not that many agents but I think the number is somewhere between 10 and 20. He said he could see no point in continuing, that he could not continue to have those agents; he would close them. I am just conveying to you what is not a threat or anything but just him speaking in club around our committee table. His is the only building society in Tassie. He would not see it as worthwhile, and he made the point: why should the agent be treated any differently from the staff anyway if the staff do not have to be licensed yet the agent does?

Senator GIBSON—The banks have been making a point in their submissions to us that the tellers, for instance, may have to be trained to fulfil that same requirement.

CHAIR—So the staff would come under the same category?

Senator GIBSON—Yes.

Mr Venga—That really depends on whether you are going to include deposit products and non-cash transactions.

Mr Larkey—Most of the staff who act across the counter are not qualified and do not give financial advice, as we understand it, and in many cases they have persons trained for that purpose in the branch. As for our client base, we have not analysed it by age but I did indicate that we have a lot of social security recipients. The reality is that many of those people who are on in years come down to us. One may have $20,000 to invest and she comes in and says, 'Deary, where should I put it?' In most cases the staff—be it with a bank although I guess it is the same elsewhere, but this is the story we hear and we have a lot of that sort of money—will offer them a deposit account in the society. They might just say, 'Do you need it in the next three months? Do you need it in the next 12 months?' If the answer is yes or no, they say, 'This is what we have to offer, this is all we do.'

To have to present to that person all the paraphernalia anticipated in the bill is only going to irritate the customer and just make the business protracted—longer and more expensive. It is all very well for government officials to try to package everything in one thing that is neat—they can go home and have a sleep at night—but they are not in the business of dealing with the people who really do not want to read too much about it anyway and have not for a long time. So it is that area where we think what is drafted would have an adverse impact on (a) our customer relations and (b) our costs, and would probably serve absolutely no good cause in assisting those particular people.

Senator GIBSON—You say in your sub mission that the definition of financial products is too broad. Is it better to go that way and exclude your building society activities from that—and I am just thinking off the top of my head—or is it better to leave the coverage and then have a couple of categories for staff requirements for particular products?

Mr Venga—Would that be in the legislation or would it be a conferred power of ASIC?

Senator GIBSON—It does not matter.

Mr Larkey—I guess what Raj is indicating is that we want the changes in the legislation. We do not have a great deal of confidence that, if you give some discretion, the discretion will be other than carried to its ultimate application. There is pressure in the finance industry of level playing fields. Everyone wants to be on this mythical level playing field. A lot of people think that banks are into deposits and that they ought to be treated the same as financial institutions that are not into deposit taking. They say, 'Why give them a special deal?'

Mr Venga—But we are ADIs.

Mr Larkey—Yes, the banks and the credit unions do come under prudential regulation, and that is one of the reasons why we do not have to have a prospectus.

Mr Venga—And there is the depositor protection under the Banking Act.

Senator GIBSON—That is right.

Mr Venga—We see that as a distinction from the normal financial planning products and the like. To have that kind of overkill regulation seems to be—

Mr Larkey—In a sense, I suppose the deposit takers have always had the privilege of not having to issue a prospectus because of the very rigorous prudential supervision. The effect of this is to put this raft of products in the same category as some of the areas in which no-one would debate that there isn't the need for some regulation and consumer protection.

Dr SOUTHCOTT—When would you draw the line for functionally equivalent products; how would you divide them up? Do you have any thoughts on that?

Mr Venga—I think in an investment where your capital is at risk then presumably you would have to have that kind of regulation. But when the product in question is capital assured—low risk, well known to your customers and prudentially supervised ADIs issuing them—you have to ask yourself whether these are the right products to be regulated in that way. You will notice that even the FSI report states on page 278 that the regulation of financial products should provide similar regulatory treatment for functionally equivalent products to achieve the most consistent regime possible. It appears to us that simple deposit products and transaction accounts which have no risk component or investment component cannot fall into the same category as superannuation products or derivatives and the like.

Senator GIBSON—That is obvious.

Mr Venga—That does not seem to translate into legislation, and we do not understand why.

Dr SOUTHCOTT—What is the spread of products that building societies would offer? Are most of them just deposit products?

Mr Larkey—Yes.

Mr Venga—And transaction accounts. That is the bulk of them. We have mortgages, obviously, which are not covered by this.

Mr Larkey—Some societies offer other products of a financial planning character. Presumably, they would be subject to the sorts of regulations anticipated. Some societies offer those as agents for others, and some of them offer them in their own capacity. But our central business, banking, is very much the predominant form of our business. We do not have any problems with what I call non-banking business being subject to legislation of this form.

Senator GIBSON—It does seem that there has been a bit of overkill in mixing your type of business with the investment product type business.

Mr Larkey—Indeed.

Senator GIBSON—That has to be recognised.

Mr Venga—And we are covered for the important aspects of disclosure in our code of conduct.

Senator GIBSON—Of course you are; you are covered by APRA.

Mr Venga—Our code of conduct is pretty comprehensive in terms of disclosure—notice periods and the like.

Senator GIBSON—The idea of putting any restrictions on using agents in rural Australia is just crazy.

Mr Larkey—Yes, it is. There has to be a flexible way to do that. There is the training issue too. If you do not have good counter staff, you do not get the business. The competitive edge these days is in the staff and in receiving and looking after the customer, so there is a lot of effort made to train the staff.

Senator GIBSON—Including the agents?

Mr Larkey—Yes, they don't just set them up. On the other hand, as Raj said, they are running a business and, as you know—you have been into these agencies yourselves—they really are just post offices. They are not there to help other than to fill in the forms and to show people what to do. If they have to give them a financial services guide and this and that—and we have all been through this process of being given bits of paper—it satisfies the mantra of

disclosure, because a person cannot come back and say, 'They didn't tell me this,' but it does not really solve the problem that we are trying to solve.

I do not think there is a problem, frankly, in the mainstream financial services offered by us and by similar sorts of organisations. I do not think there has been any case to put on that. I think we have been the subject of this competitive pressure—we know we have. It is mainly between the banks and the non-banks, but of course, as with everything, we tend to get washed up into banking. So the mistakes of some of the biggest banks in Australia tend to reflect on the whole of the deposit taking institutions in terms of public perception. It is a bit of a shame.

Senator GIBSON—Have the Treasury officials you have had dealings with and/or the minister's office understood the three key points you have just made with us this afternoon?

Mr Venga—We have mentioned it time and time again in submissions.

Mr Larkey—We have been on this issue now for over 12 months—nearly 18 months. I think the view that you will hear if you take up our case is that, 'We will apply these things flexibly. We will have flexibility.' The thing is that if it is in the law, the capacity to be flexible becomes a real problem in practice. But that is the minister's answer to us: 'We have to get a uniform system. We have to have you all in this box and then we will look at it flexibly.' It was suggested to us that our energy should be better directed in working out ways to be flexible. We really feel that we are not confident about that.

Senator COONEY—That is a fair proposition, isn't it: if you put your head in the noose, we will not pull the lever?

Mr Larkey—That is right.

Mr Venga—A large majority of our membership base is made up of people who have account balances—

Mr Larkey—We have a large number of small depositors—

Mr Venga—Very small depositors—$20 or $15 at a time—and a lot of them are social welfare recipients. A lot of these people are going to be handed out product disclosure statements and the like on the basis of opening an account only to receive social security payments. It is quite a cost impost for something which we are doing as a social obligation, as it were.

Senator GIBSON—And credit unions would have similar views?

Mr Venga—Very similar, I would have thought.

Mr Larkey—I think that when you meet them you will find that they have very similar views. Obviously, we have discussed our joint problems in the area, and they share our views—as does the banking community. I hope you get around to meeting Rob Hunt from Bendigo. He was a former chairman of mine when he was running the building society in Melbourne. He has

developed the community bank concept. In a sense, all the building societies are community banks, using similar sorts of structures. His whole structure, as I understand it, may have grave difficulty—much the same as ours.

Obviously, we want to see our institutions survive so constantly everything that adds cost is focused on. The whole emphasis of the management is on getting our costs down because our margin has declined. So any addition to cost, be it a regulation or a prescriptive piece, really causes a lot more angst amongst the directors than has been the case traditionally. I cannot overemphasise how worked up the directors of the societies are when they read this. We have been through, not for the same purpose, other efforts by governments to do certain things, like the account opening procedures mainly arising from the inquiry into bottom of the harbour schemes and all the corruption of that era. What was presented was legislation where everyone who opened an account had to go through a process. The initial legislation that Mr Bowen, I think it was, proposed required that if you wanted to open an account you had to have a Justice of the Peace, a JP, countersign your application.

Senator COONEY—I remember this. You had to have two or three means of identifying yourself. I remember this was with opening an account.

Mr Larkey—That is right. The first effort, the first draft bill that came forward on that, was a proposal that to open an account you had to fill in all the information and have it countersigned. That proved impossible and then the evidentiary data came forward and then the points system. Directors use that example only to say that once we got into that system—I suppose it is all done now—it did generate enormous animosity with customers who had to go through that process. I think that, when you are proposing changes which affect millions of people in their day-to-day transactions, one would hope that you would look at a practical approach and have regulation or requirements imposed only where they really have to be imposed and are necessary. We do not think that there is a case here.

Senator COONEY—The whole point behind it is to try to get some ethics for the whole situation in terms of the customer, the client, or the provider of the services. I suppose that all the time governments are trying to allow flexibility so that business can boom while at the same time keeping some protection in the whole system. When things do go wrong, there is a great shout.

Mr Larkey—Yes, there is indeed.

Mr Venga—But only if there has been an instance of market failure in terms of these kinds of products anyway.

Senator COONEY—But there have certainly been examples of people getting into difficulties in this general area. There is STD, sexually transmitted debt, and all that sort of stuff that you have heard about. People do get hurt in this financial area—there is no doubt about that—and I suppose government tries to guarantee protection, although I do not know whether you ever can. I suppose there has only ever been one perfect person in the world, and they fixed him up after three years, I am told. Nevertheless, there has to be at least some protection. I can understand what the minister wants to do in saying, ‘I want to make sure that people,

particularly vulnerable people not skilled in this area, are not hurt and at the same time allow business the sort of flexibility that it needs.' It is a bit difficult.

Mr Venga—But STD and like matters are amply covered by the credit code legislation nowadays. We are not talking about loans or guarantees but straightforward deposit products and transaction accounts. We cannot see any instance of market failure there.

Senator COONEY—But people have made that speech many times in the past—'Look, there really is no problem here'—but down the line, bang. So I just put that forward as an indication that there are two sides to every coin.

CHAIR—With players like Pyramid a few years ago, did that affect depositors or were the people buying investment products? Was that an investment area of the operation?

Mr Larkey—He engaged in activity to mislead people. He was a crook and, unfortunately, he had the guise of respectability. He was marketing shares, in fact, and people thought they were deposits.

CHAIR—So that would not be affected by this?

Mr Larkey—There is always going to be someone coming along and misleading people.

Senator COONEY—What government or legislators have to worry about the whole time is how much protection you can give. As you would remember with Pyramid, people took the investment and the percentages being returned were fairly high, but that did not seem to affect the outcry that followed. It gave governments problems and all those sorts of things.

Mr Larkey—Yes, and the State Bank of Victoria and the State Bank of South Australia were monumental collapses.

Senator COONEY—You were saying before that if you have staff on the ball and management with an appropriate proper and ethical approach that is the answer. I suppose a lot of this legislation is really writing checklists for your people at the counter.

Mr Larkey—Yes, it is very prescriptive. No doubt the knowledge rests with the federal Treasury to tell everyone how they should behave and what their ethics should be. I do not think anyone has a mortgage on that, including the government; there is a whole debate about the ethics of businessmen. Sure, Corporations Law certainly attempts to do that, but I think we are probably taking a sledge hammer to crack a nut with this particular issue these days.

Mr Venga—If it were found to cause problems subsequently, the proposed legislation does make it mandatory to have external resolution processes, which will have accompanying compensation arrangements. So, in that sense, you are covered as well.

Senator COONEY—If you want to go to compensation and press your case, the problem is that it costs big money.

Mr Venga—But it is proposing a free one; it is free to the customer, and that is in the proposed law. We have it voluntarily at present but it will be law.

Senator COONEY—I do not want to sound cynical but, with mediation, arbitration and what have you, in the end you have to have that backed up by a competent legal system.

Mr Larkey—Indeed, yes. We are in a period when people like disputing things, as I am sure you know. Fortunately for us the societies have not got a systemic problem, and it has been a big problem for the banking sector. You wonder sometimes whether having the dispute and complaints resolution scheme stimulates more complaints.

Senator COONEY—I think there is no doubt that it does.

Mr Larkey—It sure does. Unfortunately, our experience is that a lot of the complaints are really people just getting things off their chest on a whole range of issues. Fortunately, we do not have very many of them, and we are very lucky in that way. But, being part of the deposit taking institutional family, we are required to incur the expense and the cost of having a system like that. The reform of the financial system, as far as we are concerned, has been very positive, bringing all the societies in under one single piece of legislation. The weakness of the system was that both the State Bank of South Australia and the Pyramid group were running in a state based system and there was really no prudential supervision worth a pinch of the proverbial applying in those cases. So I think this system has addressed that.

As for consumer protection, which is primarily what this is about, certainly there was a case for that in the booming financial advising industry, the booming superannuation industry. Once government has said that superannuation is the preferred form of savings, then in a sense the government has an obligation to make sure that the system is decent. Frankly, in those days I would have preferred governments to use the banking and building society deposit structure as a legitimate form of superannuation savings. Unfortunately, we were excluded very much and some of us had to then go down to basically what was a pretty expensive system that applied in retirement savings. In looking at a review of retirement savings, which the government is contemplating, one would hope that it would see the deposit taking sector as being a legitimate place for some retirement savings to reside in. Obviously, with retirement savings you want growth; you just do not want interest returns. But there is certainly a place for us in that end of the market. In a sense, retirement savings accounts were an attempt to bridge the complex super system and the simple deposit system. In the end I think the attempt fell in between and it has not really been a terribly great success. For small accounts it has become too costly to really promote the RSAs.

CHAIR—Would you enlarge on your concerns about the definition of retail client? You say the definition should be referenced to a point in time. What is your concern there? How will your proposal change it?

Mr Venga—Our basic concern—and I think the banks would share a similar view—is that the definition as it stands is such that if an employer's work force changes over time you may well be affected by this legislation, although when it started off you may not have been. We are looking for certainty here and we thought a better approach would be to take the approach of the consumer credit code with what they call a business declaration test. If someone were to take a

loan, if it were not covered by the credit code, if it were not for personal, domestic or household purposes, they would sign a declaration et cetera and at that point of time it would be valid for the entire length of the loan. You would not expect the provider to monitor actively whether something was or was not within the legislation.

Obviously, it could be subject to abuse, because you could see some high pressure selling technique saying, 'Just sign this declaration and we will give you the loan at a lower cost schedule.' I think some disreputable suppliers of finance out there at the other extreme of the market were doing this at one point. But there is a penalty under the credit code in that, for one thing, the declaration will not be valid, so if it is challenged it does not apply and they cannot say the credit code does not apply. So it seems to have worked very well and it is certainly effective. It is low cost and it provides certainty, which is the most important thing. It is not a huge concern of ours but we can see problems with this emerging.

CHAIR—As there are no further questions, thanks very much for appearing before the committee and for the evidence that you have given to us.

[2.34 p.m.]

HUTCHINGS, Mr Andrew, Managing Director, APIR Systems Pty Ltd

RILEY, Mr Andrew, Director, APIR Systems Pty Ltd

CHAIR—Welcome. We have before us your submission, which we have numbered 48. Do you wish to make an opening statement before we proceed to questions in relation to your submission?

Mr Hutchings—If the committee is happy with the general outline that they have received from the submission, then I am happy to forego any opening statement and move to questions.

CHAIR—How do you see the bill facilitating efficiencies, both for businesses and for savings for consumers, in relation to electronic collection and dissemination of compliance reporting?

Mr Hutchings—There is a number of benefits inherent in the new bill, based upon the fact that it is moving forward into a totally new environment. The bill is arriving at a time when there is a total environmental change in the financial services industry, and I think it needs to be seen in that light. We have the external forces of globalisation and the drive for increased efficiencies. There is also obviously savings and financial awareness rising in the community, and there is a need to drive down costs. So there is terrific pressure on all parties to drive down costs.

There is an understanding across the industry that there is a need to improve the way in which the industry operates. It is currently heavily paper based. Part of that is regulatory, in as much as up until quite recently there was no provision for prospectuses for investments to be placed through an electronic medium. They had to be paper based; they had to be signed off by the investor. With that change we see the potential for, as I say in the paper, straight through processing, whereby the adviser can actually sign off on the investment for the client, the investor, and it can move straight through the whole investment administrative process to be registered in a short time and to be then processed in an efficient, timely and cost effective manner. There are a lot of advantages to the industry, and obviously the client, in that environment.

The problem is that it brings with it a number of difficulties. One of those difficulties is that without the human interface in the process you are actually lacking in opportunities to check what is going on. The current regulatory regime for advisers—and I am using a collective term here to cover everyone who offers investment advice—tends to be a little less than stringent. The hurdle is set at a very low level, and the checking of those requirements are actually quite minimal. That is a product of the industry and the way it has developed. There is no criticism meant in that comment; it is an observation.

This bill actually offers the opportunity to not only raise the bar for the compliance area and the professionalism of the whole financial investment area but also move into a proactive way

of actually monitoring the advisers. At no point will you ever get between the adviser and the client, and no system would ever want to do that, but from the moment money is handed to the adviser there is a possibility, using the new electronic medium, to actually test the said adviser is compliant in all the ways identified under the bill—for instance, that they belong to a complaints resolution scheme, that they do have professional indemnity insurance that is current, that they are trained to actually be financial advisers, that their training is current or relevant to the products involved and that they are dealing through a compliant licence holder. The necessary data can be gathered, it can be checked and it can be tested, so that the investor, the retail client, can know that for that transaction to go through in an electronic manner that adviser is someone he or she should be able to do business with. That is a major step.

What also happens, given the layout of this system, is that, once the investment is made, there is the opportunity for ASIC, as an external party, to actually undertake auditing of the complete system, which is not currently available under the current regime. One of the problems in the current regime is that, as I said the hurdle is set quite low, the checking system at the fund manager insurance or banking agency is actually not time sensitive. Whilst the industry does maintain exceptionally good monitoring of its own advisers—a large institution that has a distribution arm will monitor its own advisers quite closely—there is no crosschecking across institutions or across the myriad independent advisers, or advisers who come into the range of the company on an infrequent basis. One of the problems is that, once someone has been checked by the financial institution, it may be some considerable time before their credentials are checked again, and in that time there can be major lapses. Obviously, the retail investors can be highly exposed. One of the reasons APIR exists is that a number of the shareholders in the company have been exposed to such risk.

Senator GIBSON—What does your business do now? It appears from the submission that this idea has arisen out of something that your business is actually doing. Presume we are pretty ignorant, which we are, and start from scratch to fill us in on what you do and how this arose and, for this proposal, who are your customers?

Mr Hutchings—Back in the late eighties, early nineties, the industry, which until that time had been internally focused on its own distribution networks, suddenly found that it had to do business with more and more independent advisers. At that stage, the option was to pick up a computer, take it down to the adviser and say, 'If you do business with us, we will give you a computer.' Independent advisers could only fit so many computers into their offices. So the advisers bucked up and said, 'No, we actually want to get this organised. You're the big players, you're the guys with the big systems, sort it out.'

A committee was raised between the Financial Planning Association and the old Investment Financial Association, which was one of the institutions rolled into IFSA. As part of that whole development of open systems, it was immediately realised that this was an industry which dealt with products that were intellectual constructs, and there was no way of going out to the lot and saying, 'We built 35 Commodores today; they are red or blue or whatever.' You actually had to hope that there was some way of defining them and maintaining them. The concept was developed by members of that original committee that they should actually identify the products and code them. So there is a dual process of identification and coding for these products and, once electronic transmission started, identification of the players in the industry as well—that is,

the participants, whether they be advisers, dealer groups, fund managers, custodians or whatever.

This process was developed between 1993 and late 1997 when the company running the intellectual property for the industry went through a bad time. That intellectual property became available through a liquidator. A group of us, who had lost considerable amounts of money to the financial institution involved, decided that we could actually do something with this, and we bought the intellectual property from the liquidator. IFSA—which at that time was going through its reorganisation after its mergers—and Richard Gilbert—whom most of you probably know—took us by the hand and led us through the industry, because we were absolute babes in the wood. One of the first board decisions made by IFSA was in fact to make the APIR coding system the industry standard. Since that time, we have added something like 8,000 products, 145 fund managers. We have about 90 per cent to 95 per cent of the companies and products and about 99 per cent of the dollar value of the industry mapped using our identification and coding system. It is used throughout the industry.

The codes are used by fund managers to download information to the research houses that then publish it in the *Weekend Australian* or the *Financial Review* or provide it to financial planners. It is also used by software developers such as Vision FPS, which is one of the biggest software providers for financial planners. It is used to download the data into that software, so they have got a complete usage. So the product side is exceptionally well used.

Because of the lack of electronic activity in the actual processing from the adviser back to the fund manager, the adviser side was actually being reviewed at the time that CLERP 6 came along. Subsequently what happened was—as I think I said in the paper—we were actually approached by the IFSA working group to see if we could find a solution to their problems. The example given was that if you moved the companies—some of which have very high floating populations of advisers who write business to them using the old system, which was each company keeps it own system—to the new regulatory regime they would have to quadruple the effort they put in, because you would have this floating population writing one bit of business a year to them and they would have to put in $2,000 or $3,000 worth of effort into checking their compliance.

So they came and asked us, as the standards providers to the industry, if we could look at it. We subsequently did. We got legal advice from Deacons. We went back to the working group—and I think I have listed off the companies that were involved in that working group, and they are the heavyweights on the insurance side of the industry—and they all agreed that they wanted to move forward with it. So we took it up at that stage, realised it was bigger than anything we had ever done as a small company and went to the National Office for the Information Economy. They agreed to facilitate the stakeholder meetings, because the stakeholders were actually industry associations, which was actually another level up from what we were used to working with. Where we are at the moment is we have just completed our second stakeholder meeting. We had in principle endorsement from about everyone associated with the stakeholder meetings, and we are moving forward to put the technical team together now to actually build the system.

Senator GIBSON—In future, if I am individual agent out selling whatever products I had, would I subscribe to be part of your system and provide the information?

Mr Hutchings—Yes and no.

Senator GIBSON—Tell us what happens.

Mr Hutchings—What will happen is the database will be built as an information exchange. For each datum point in the database there will be an authorised provider of information. So for professional indemnity insurance it will be the insurers. For training it will be the various institutions that provide training to the industry, et cetera. So the individual will only apply to be on the system—they will have access, obviously, to monitor the data that is kept on them—but in principle they will not be responsible for putting data on the system. It is totally a third party data input.

One of the problems in the industry is that at the moment there is considerable room for people to get around the current regulations. An example that was given is that an adviser may come on to a company as a proper authority holder—therefore, is independent—be responsible for his own PI and, before he can write business or receive commission, take out a covering note from an insurance company, and after 30 days the thing lapses and he practices for 11 months and all of his clients are not covered by any professional indemnity interest.

Senator GIBSON—So you will be the industry's register—

Mr Hutchings—Yes. And they will pay a small annualised fee to be on the system.

Senator GIBSON—But an individual agent would not pay you a fee to get on the system.

Mr Hutchings—Two hundred dollars a year is what we anticipate.

Senator GIBSON—Your costs will be mostly covered by the major firms.

Mr Hutchings—Correct.

Senator GIBSON—AXA, AMP, et cetera.

Mr Hutchings—Exactly. And there is a lot of layers of access into this database. The first one is the adviser, and he can access it for two reasons. Firstly, he can access it to find out that we are keeping honest information about him. Secondly, he can use it when he changes location—because under the new act a lot of these guys will drop off the ASIC radar, so there will be no industry awareness as to what their professional background is—and we will be able to provide people with a historical record of their activities within the industry. They will be able to use that to support job applications, et cetera. They are the two levels for the individual adviser.

For the smaller dealer groups—and there are many of these; individual accountancy practices or small groups who have gone out and got themselves a licence under the existing regime—it is a financial overhead. They are often quite pleased when other accountants, lawyers or whatever come to them and say, 'Can I get a proper authority under your licence?'. They say, 'Great, we'll get rid of some of the costs of this darn thing.' The problem is that they do not

have the resources to actually monitor the compliance of those people, because quite often those people are geographically disparate. They are spread all over the country, and these businesses do not have the resources to go thither and yonder to check on things. So these small dealer groups will be able to receive advice on reports from the system on what a person has done in the industry. When they come to work for them, we will be able, in fact, to tap into this to make sure that they are proper authority holders or 'responsible authorities', as they are going to be called, and are continuing to maintain their compliance in a different geographical location. That is a major step forward, I believe, for these small groups and that should reduce some of the costs inherent in them maintaining their compliance regime. Large dealer groups are very interested in it because at the moment they have terrific expenditure in maintaining just their own people and they are also worrying whether or not about this and that sort of thing when someone comes to work for them. They—the AMPs and the MLCs of the world—are quite keen.

The fund managers fall into two basic groups. The insurance industry is still very keen because of the joint and several liability issues under the act, and they want to maintain it. As I said before, there are terrific costs for them because of the high liability and high cost type of system. The other group is the technology providers in the industry. These are the people like Macquarie Bank and Bankers Trust, who are the major infrastructure back office providers. At the moment, they see a vast churn in the amount that are doing business with dealer groups and advisers of companies. For their systems to be able to then deal with the fund managers they are actually talking to, they need to be able to get some basic standards in place of identifying and checking the compliance of the advisers. They are processing business for and on behalf of these various fund managers. They are very keen and there is a very strong push from that end of the industry to participate.

The industry associations, in general, are supportive; IFSA is very supportive. But we are working our way through the labyrinthine processes that go with any big industry association. There are other players who are quite keen to see something like this happen. We had a long chat with Louise Sylvan from the Australian Consumers Association. The association was very keen that the information we are looking at gathering, at least in a synthesised form, will eventually at some point down the track allow a consumer to actually get on the web and look up someone's name to see if they are compliant through a very simple yes/no type of response. In fact, most of the queries will be placed on the database mainly by big fund managers, either at the point of when they receive business written to them or when they want to pay commissions. They will query the database and they will get a response from the database not dissimilar to what you get when you go to an ATM.

Senator GIBSON—Are you planning to charge for the responses?

Mr Hutchings—Consumers?

Senator GIBSON—Whomever.

Mr Hutchings—To the fund managers and dealer groups, yes, there will be a charge, because that will be a full inquiry charge and there will obviously be liability for us involved in that.

Senator GIBSON—They will pay you to be part of the system anyway and you will also charge them for the responses.

Mr Hutchings—Yes. The big fund managers will be the major users of the system—the big insurance companies, the BTs, the Macquaries and whatever.

Senator GIBSON—I understand your case for a monopoly voluntary system covering the whole industry. It sounds a damn good idea. Assuming you are successful in getting it off the ground and making it work and that you are then in a monopoly situation with this information, what is to stop you from jacking up your prices and pushing out the small guys?

Mr Hutchings—When we went to IFSA back in April 1998 and we were discussing this with them, one of the things that became very apparent was that we, as a company, have a number of points at which we interact with the industry. We are actually part of the industry infrastructure, so we are not a player, we are a white hat within the industry, and we are very keen to maintain that. We work very hard to maintain a reasonable cost infrastructure model. In fact, our performance to date has been such that a number of the companies within the industry have looked at what we are doing and how we do it. Basically, they are a bit like any big bureaucracy in that they have overheads and they cannot compete with us anyway. We are a small business and that is what we do.

CHAIR—Are there any other questions?

Senator COONEY—What about the integrity of the information with privacy principles and what have you? You would know that in the credit references system there are real problems. There are two things that come out of that—firstly, whether the information is accurate; secondly, whether the person has an opportunity of seeing it, whether a company or not is involved, to see whether it is correct. What do you do about those things?

Mr Riley—The way we are putting it together is that first up we are going to have a privacy code of ethics that we will submit to the Privacy Commissioner, which will cover all the 12 points that they recommend that you do. The system will be set up so that an individual adviser is able to access the information we hold. If he has a problem, we will have a call centre that he can ring up and ask for an explanation. If it is something simple like somebody entering the address incorrectly, it can be changed on the spot. If it is something that refers back to one of the other authorised data providers—for instance, somebody has reported that for the training he has done they have put the wrong course number down or something like that—we check back with the training provider. Of course, on our system it will have the fact that it is an approved training provider under the act and all that sort of thing. If there is a dispute, there will be a third party arbitrator nominated, and along the provisions of the privacy recommendations there will be a procedure. As I understand it, we will agree to accept the decision of the third-party arbitrator and make the change.

Mr Hutchings—One of the interesting things about this industry is that it is global. There is a large, vigorous discussion going on between the US and the EU over whose privacy standards will be used. The EU fired a shot last year that basically said, ‘We don’t not care what you use in your own countries but unless you use our standards throughout your operations you’re not going to be allowed to do business in the EU.’ That is not threaten-speak that has been carried

through at any stage, but what that means to us is that we have to be aware of what the world's best standards are. As Andrew said, we are looking to put these systems in place, and we also have to be very, very aware that there are other agendas floating around out there which impact on the way we do business.

Senator GIBSON—Are there other parallel systems to what you are doing in other countries?

Mr Hutchings—No. In fact, the whole operation of APIR is unique anywhere in the world. To use the jargon of the dotcom world—although I am not sure if you should these days—ours is a company that is global just by the basis of what we do. We have already received a number of inquiries from the countries within the region who want to know about how we are doing what we are doing.

Mr Riley—For instance, we are already doing New Zealand products.

CHAIR—Given your general support for the bill, and from your particular perspective, are you aware of some of the concerns that have been raised in particular with this committee—for instance, by the banks in terms of the problem of counter staff having to comply, to be trained, and the cost of that?

Mr Riley—Yes, we are aware of that.

CHAIR—Have you any input into those issues? Do you have a perspective?

Mr Hutchings—We actually had Westpac along as a banking representative at the very first stakeholders meeting. They gave us terrific feedback on what their concerns were on this issue, and when we had the second stakeholders meeting last week we actually went back over all the issues. We are a service provider, so we are not actually in there in the argument's cut and thrust stage—and we do not want to be—but it panned out from the discussions that came through that basically, if someone just hands across a brochure because someone asks for it, there is no issue with that; there is an issue the moment you give advice.

One of the issues that we have been trying to work out is who should be on our system. We do not want all of Westpac's, the Commonwealth's or NAB's counter staff floating in and out on our system. It would just make the whole thing unworkable. So you have really got to get down to some degree of honesty by those institutions. They are so sensitive, anyway, to this sort of bad press scenario that I think there is a fair bit of pressure on them. We have what we call in work terms 'a practitioner'. An adviser is a practitioner—that is, someone who is in the industry and who is offering advice and whatever. The rule we have taken is that, if anyone does anything that requires them to have tier 2 training—tier 2 is the lowest, isn't it?

Mr Riley—Tier 2 is the lowest.

Mr Hutchings—I can never remember which one is the lowest. Anyone who does anything that has the lower level of tier training requirement is immediately an adviser. That is the benchmark we have used, and the insurance people and the financial planners seem to be very comfortable with that.

There are two problems with banks—there are two problems with anyone who has employees who could be seen to hand something across a counter—and the first is that, under the new regime, employees are not required to be registered with ASIC. I think that is the right move. That has taken a lot of onerous tasks off a lot of companies that employ people who never give advice but who have to keep up the proper authority just in case. However, there are two issues. The other one is that, if you take people who give advice, they must be there and they must be advisers and registered as such. As an employee you do not have to tell anyone about it, but anyone who does business with that employee's company, or any fund manager whom an adviser of that company does business with, must still know that that employee is authorised and how they are authorised.

There is a sort of confusion in the industry, I think, between telling ASIC who is an adviser for regulatory reasons and telling the industry who is an adviser for straight-out commercial efficiency reasons. I think there is a fine line there that needs to be separated out, because our system is about notifying the industry who is allowed to practise. So when someone from Westpac writes a bit of business for Rothschild, Rothschild will automatically be able to show that person A is allowed to write business and that they are allowed to write business against that product, et cetera. That is a different argument to the one of: is he an adviser and should we maintain all the records on him? I hope that is helpful, Senator.

Senator GIBSON—It is useful.

CHAIR—There are no further questions. Thank you both for appearing before the committee and for the evidence you have given us.

Committee adjourned at 3.02 p.m.