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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Reference: Financial Services Reform Bill

TUESDAY, 25 JULY 2000

MELBOURNE

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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Tuesday, 25 July 2000Tuesday, 25 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 and Cooney

Terms of reference for the inquiry:

Financial Services Reform Bill.

WITNESSES

Committee met at 9.49 a.m.

FREEMAN, Mr Ross, Partner, Minter Ellison

AVIS-KEAST, Ms Julia, Senior Associate, Minter Ellison

CHAIRMAN—I declare open this public hearing of the Parliamentary Joint Statutory Committee on Corporations and Securities and welcome the witnesses who will be appearing before the committee today. The purpose of the hearing is to take evidence on the committee's inquiry into the draft Financial Services Reform Bill. This is the third hearing on this particular inquiry. The committee has received and published 61 written submissions, which it will consider along with the evidence it receives during its 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.

I welcome our first witnesses this morning, representatives from Minter Ellison. We have your submission before us, which we have referred to as No. 2. Do you wish to make an opening presentation to the committee in relation to your submission before we proceed to questions?

Mr Freeman—Not unless there are specific questions. The submission is designed to be complete. I suppose that the only point the submission does not make clear is that there are currently provisions under the Corporations Law which allow a person to be banned without the holding of a hearing in some circumstances, such as if a person has been convicted of a serious fraud or if they have become insolvent under administration. In those circumstances, they can be banned without a hearing. Our submission is not based on considering those issues; rather it considers other instances.

CHAIRMAN—We will proceed to questions. Have you developed a view as to why the legislation is being changed in this way from the current circumstances?

Mr Freeman—No. I do not see why the legislation has been changed to allow a banning order to be made without a hearing. I can think of no policy reason why that is the case and I have certainly not heard of any policy reason that justifies why that is the case.

CHAIRMAN—Have you had discussions with Treasury on the issue?

Mr Freeman—No, I have not.

CHAIRMAN—Or with ASIC?

Mr Freeman—The only discussions I have had with ASIC have been on an informal basis. The impression I have is that they would prefer a process that was open and transparent. I do not know whether they have formulated an official position. I do not think they have. I would be surprised if they supported the abolition of a banning order hearing prior to a banning order being made.

CHAIRMAN—As I understand it, the bill also does not require ASIC to provide a banned person with any details of the circumstances in relation to the banning order.

Mr Freeman—Not prior to the banning order being made, that is correct. The draft bill, as it stands, says that ASIC may make a banning order and the banning order is then given effect by service of the banning order on the banned person. There are provisions which almost allow an appeal after that banning order has taken effect, which ultimately might result in what is described as a private hearing, although by that stage the fact of the banning order will have become public knowledge. It places the banned person in an invidious position to have to try to have a banning order overturned after the event. There are some very practical reasons why that would be difficult. There are also some financial reasons which would make it difficult: the person is presumably out of work at that stage or not doing what they had been doing. There are also issues of reputation which would be affected by the publication of a banning order, which might ultimately be reversed at a subsequent hearing.

CHAIRMAN—Is that where the issue of changed circumstances comes into play or is that an alternative procedure?

Mr Freeman—I suppose that is the first step. The first step is that a person can ask ASIC to vary or revoke a banning order if they can show changed circumstances. It is not clear from the bill what might constitute changed circumstances, and I suppose it does presuppose ASIC at that stage, giving the person a summary at the very least of what circumstances led to the banning order being made. I suppose our difficulty with it is that, in the absence of an opportunity to put views to ASIC about why a banning order should not be made prior to it being made in some instances, the purpose of the banning order may not be served. The purpose of a banning order, as the law currently stands, is that it is not a punitive measure; it is a protective measure. It is there to protect the investors and we do not have an issue with that. But often during a banning order hearing a delegate, on hearing materials from the person who is the subject of the hearing, is able to consider issues which would lead him or her to believe that a banning order is not necessary to protect the public. For example, it may be that the conduct complained of happened some time ago in circumstances which are explicable by the person who is the subject of the hearing. It may be that since that time the person has undergone further education or whatever. Without an opportunity to have those views put to a delegate of ASIC prior to a banning order being made, those issues cannot be considered. When they are considered by a delegate, if the delegate believes on the material that has been put before him or her that whilst there may have been a transgression of the securities law or conduct which is not efficient, honest and fair if, nevertheless, the delegate believes that it is not necessary to protect the public to impose the order, none can be imposed according to the law as it currently stands. So that is really the opportunity that is missed without a hearing first up.

There is also an opportunity to put forward a defence. Often any banning order material which is currently served on a party has within it a view of ASIC that a banning order should be imposed, but it is a preliminary view and it is based on materials that ASIC has been able to gather during its investigation. It typically contains examination transcript from compulsory examinations that ASIC has conducted pursuant to section 19 of its act, but it does not always contain all materials that a person could put forward to explain their conduct. Sometimes, for example, because lawyers are entitled to represent a person at a banning order hearing, there might be legal argument that can show that there has been no transgression of the law. So there

is a legal defence that you can run. As I said before, it may be that the transgression was a one-off incident explicable by circumstances which had not become apparent during ASIC's investigation. So I suppose it is the opportunity to present your case or your defence that is lacking from the current bill.

CHAIRMAN—So the opportunity to seek a variation of the order is separate from the opportunity for a private hearing.

Mr Freeman—Yes.

CHAIRMAN—But in both cases that comes after the banning under the proposed regime.

Mr Freeman—That is the case, yes.

CHAIRMAN—They are separate procedures?

Mr Freeman—Yes.

CHAIRMAN—Or does one lead to the other?

Mr Freeman—There is a sequence. The first step is the imposition of the banning order, and one assumes that to do that ASIC has formed a view on material it has gathered during its investigation. Once the banning order is served and takes effect, the person who is the subject of the order can then apply for revocation, but by the look of it that is on certain limited grounds, whatever the changed circumstances are. The step after that if the revocation or variation is not made is that the person has a right to a hearing. So it is a three-step process but it all relates to the same material.

CHAIRMAN—Whereas with the current regime the right to the hearing precedes the banning order?

Mr Freeman—That is correct, yes.

CHAIRMAN—In all cases?

Mr Freeman—In all cases, save for cases where a person has been convicted of serious fraud or they have become an insolvent.

CHAIRMAN—Yes, those exceptions you have outlined.

Mr Freeman—Yes.

CHAIRMAN—So in the present situation the person is advised that there is an intention to ban them and they then go to a hearing.

Mr Freeman—That is right. They receive a notice of hearing, and the practice has developed that it sets out the grounds upon which ASIC believes that a banning order should be imposed.

As I said, it also usually contains materials on which ASIC has come to the conclusion that a banning order at prima facie should be imposed. The material is then put before a delegate. The person has an opportunity to appear at a hearing, and they can take advantage of that right if they so wish, or they may not. They then have an opportunity to put their case, as it were, either through written submissions or through an appearance in person. Under the banning orders at the moment, the ASIC procedures are conducted with as little formality as possible; nevertheless, it is a natural justice hearing, so you do get an opportunity at that stage—prior to any hearing and prior to any publicity being announced—to put your defence. Under the current system, once the banning order is made it then becomes public, and any appeals have to be conducted in public through either the Federal Court or the Administrative Appeals Tribunal.

CHAIRMAN—Does the current system have any defects, either from the point of view of consumer protection or from the point of view of the person who is potentially going to be banned?

Mr Freeman—In my experience, it can be a complicated process to work out whether a person has a good defence to a banning order hearing. If they do want to conduct a vigorous defence, like all legal proceedings it suffers from an aspect of cost. To some extent, that is addressed by ASIC's hearing manual, which has attempted to streamline the procedure and to take the formality of a court out of the proceedings. It is a natural justice hearing, so rules of evidence do not apply; nevertheless, when you are dealing with issues that might concern market manipulation or other aspects of conduct which are regulated under the Corporations Law and are quite difficult, it can be a reasonably costly exercise. But that is probably a criticism you could make of any court proceedings these days—there is a cost aspect to it.

The way the hearings are conducted at the moment, the delegate who hears the case is usually an employee of ASIC. ASIC is also the organisation which has put together the brief, and clients sometimes find it difficult to understand that the representative of the body that has formed the view that a banning order should be imposed is also the person who conducts the hearing, but the delegates I have come across have operated with the utmost integrity and I have never had a problem with issues of bias or perceived bias. I think the delegates that ASIC chooses do the job very well. I think that is a recognition from ASIC that it is a serious business and that they need to have good people performing that function.

The difficulties I have had in the past are more in the collation of material that is put together to constitute the brief of evidence—for want of a better expression—or the hearing materials that are put before the delegate. Sometimes what is included in the folder of materials is not all that one would hope is included, from the perspective of acting for a person who is the subject of the hearing. Sometimes on inquiry of ASIC there are further materials which ASIC has collated and which have not been included in the hearing materials and these can be very useful in conducting a person's defence. I use the word 'defence' loosely; it is not a trial, so it is not a defence as such but an opportunity to put a different point of view. The hearing, insofar as it has integrity, will always be as good as the person hearing the case and will be as good the materials that ASIC put forward.

In all fairness, materials that form part of the brief should be materials that are both relevant to proving or supporting ASIC's contention that a person should be banned but it should also include material that is exculpatory, and provided there is an even-handedness or a fairness

there the system will work well. But sometimes in practice that does not happen, and we have, on occasion, had to make further inquiries of ASIC to be allowed to look at additional materials that it has held but has not included in its brief. That is my only criticism.

CHAIRMAN—What about from the point of view of consumer protection in the current procedure?

Mr Freeman—The consumer is protected because the overriding consideration in whether a banning order can be made is whether it is necessary to protect the consumer. As I said before, it is not a punitive measure. The fact that a person may have breached a provision of the Corporations Law or has not acted efficiently, honestly and fairly is not enough in itself to warrant a banning order. At the end of the day, the delegate has to be guided by whether it is necessary to protect the public. If the delegate forms that view a banning order should be imposed. The consumer is also protected because, being a natural justice hearing and being conducted with as little informality as possible, there is a reasonably tight time frame. The hearings are usually conducted within a couple of months of the notice of hearing being served—and sometimes much quicker. ASIC reluctantly agree—and I can see why—to adjournments or further time to allow a person to prepared the materials. They really take that on a case-by-case basis. So there is a need to hold a hearing as expeditiously as possible. From a consumer protection point of view, there is speed and there is informality which work together to ensure that, when ASIC forms a view that a banning order should be imposed, things move quickly to resolution.

CHAIRMAN—So you cannot see any logic to change from that position to the proposed process?

Mr Freeman—No, I cannot understand why the change is there. I must say that it is perhaps not entirely clear that that will be the consequence if the bill is passed in its current form. This is another aspect that we have raised in our submission. Under the bill, the decision by ASIC to ban someone is still an administrative decision and is, arguably, still subject to natural justice. Natural justice has a variable content: in some instances it requires a hearing and in some instances it does not. The difficulty we have is that, where there has been amendment to the law to take away specific reference to a hearing prior to a banning order being made and it has been replaced by a law that says you can have a hearing, at the end of the process, it is a question of what natural justice would require of ASIC prior to making a banning order hearing. Would it in those circumstances say that a hearing is still be required, despite the fact that, at the end of the process, there is a specific legislative right to a hearing? On one view you might argue that, with the right being taken away and with the right of a hearing at the end of the process, there should be no hearing prior to a banning order being made. I suppose it takes the certainty out of the current legislation. The courts would, no doubt, adopt a position after some litigation and would formulate what the content of natural justice should be if the bill is to remain in its current format. But, again, we do not see the benefit of that. Such a position might not come out after one court case; it might take several. We do not see that there is an advantage in allowing that uncertainty to remain if the bill is passed in its current form.

Senator COONEY—Proposed section 889A says that ASIC may make a banning order against a person by giving written notice to a person if it suspends or cancels an Australian financial services licence held by the person. Do you have any problems with that?

Mr Freeman—No. Section 889A ties in with other provisions in the bill which affect the holder of the licence. In those circumstances the holder of the licence can only have their licence revoked after a hearing.

Senator COONEY—And you would have no problem with (c), I suppose?

Mr Freeman—No.

Senator COONEY—So it is (b) that is the problem?

Mr Freeman—It is (b) that is the problem. I must say that it is not clear what is meant by the words 'the person has not complied, or will not comply, with its obligations under this Chapter' because, unlike the current legislation, there is no provision in the bill which sets out specifically what the obligations of the holder of a proper authority, using the current language, are under the Corporations Law as it stands at the moment. There are specific indicia of conduct which a proper authority holder is to obtain. In its base term, it is that they have to act efficiently, honestly and fairly. If they do not, they can be subject to a banning order hearing. Likewise, if they breach a provision of the Corporations Law, they can also be banned after a hearing. But that sort of detail is absent from the bill as it currently stands.

Senator COONEY—So there is no criteria by which you can measure whether or not the belief that ASIC may have is reasonable?

Mr Freeman—There is no benchmark standard which is set out in the bill, although I note there is provision for such to be made under regulations.

Senator COONEY—Say that it was not cancelling a licence. Say that the police came down and arrested a person who was doing financial transactions and that you had him or her locked up for some time. What would you say about that? Is that a reasonable course to take? The reason I ask you that is that there are instances where you do have people stepping in and taking quite dramatic action without there being a hearing.

Mr Freeman—In those circumstances, there are other options available to ASIC. Because they are charged overall with consumer protection, they can take civil action in some instances to protect investors' funds—for example, if they were at risk by conduct. They can do that in the absence of police involvement, and they does so regularly. They are able to seek injunctions from courts to freeze bank accounts if they can point to specific conduct which endangers investors' funds. But this is a separate process. This process of a banning order usually happens after the dust has settled, so to speak. It is an administrative process which determines whether a person is able to hold a form of licence or be the representative of someone that holds a licence.

Senator COONEY—In effect, the provision seems to provide machinery whereby a person can be stopped from dealing.

Mr Freeman—Yes.

Senator COONEY—What happens if, say, the Law Institute reasonably believes—or even believes—that a solicitor is carrying out defalcations? Can it then close the practice down?

Mr Freeman—I am not an expert in this area, I am happy to say, but I think the same principles apply. As I understand it, some form of hearing would have to be held before a person loses their practising certificate.

Senator COONEY—Is that right?

Mr Freeman—Again, I am not sure. But certainly the notices I have read in the *Law Institute Journal* talk about determinations made by the—

Senator COONEY—I do not purport to know much, but I thought there was some provision whereby they can stop the practice functioning without a hearing.

Mr Freeman—They can. In a similar way to the way in which ASIC can operate, I understand that the Law Institute could, for example, move to appoint a receiver over a practice where there has been a defalcation. But, again, I am straying out of my area of expertise.

Senator COONEY—What happens if you have, say, a dangerous situation in a workplace? Do people have to keep working even though it is dangerous until there is a hearing about it? Again, I do not purport to know it all. What I am really asking is: is this a unique provision?

Mr Freeman—I do not think it is, because ASIC has very wide powers under other parts of its act where it can take action. Under its act and under the Corporations Law it can take urgent action against individuals who ASIC believes are breaching provisions of the Corporations Law. It does so on a reasonably regular basis if it believes that such action is necessary to protect consumers' interests. The most obvious example of that is if ASIC believes, say, an adviser is putting investors' funds at risk, ASIC would have power under the Corporations Law to apply to the Federal Court for an injunction to freeze that bank account.

Senator COONEY—I suppose that is a problem. It is a matter of how quickly you want the action taken. How long would it take to get an injunction from the Federal Court?

Mr Freeman—You could walk up there now, provided there was the urgency. If ASIC had in its possession information which it believed it could rely on, then ASIC, like any potential litigant in our system, could walk across to the Federal Court without any paper and make an application for orders restraining someone from doing something. Obviously, the more time you believe you have, the better prepared you can be. The courts are there for that purpose.

Senator COONEY—Would the court give an injunction on the basis that ASIC made up any loss to the person against whom the injunction was obtained if —

Mr Freeman—Yes, there is always the issue of an undertaking as to damages.

Senator COONEY—So you would say that would be a fairer way of doing it because if there was nothing wrong with the way the financial dealer was carrying out his or her work, then he or she should not be ruined or disadvantaged by the action of ASIC.

Mr Freeman—In instances that require urgent action like an injunction, that machinery is there and it is not really the subject of our submissions or the proposed changes to the bill. The banning order proceedings are used usually at the end of an ASIC investigation where along the way ASIC may have contemplated whether it is necessary to take some sort of urgent earlier action through the courts. It is really a procedure which is there once ASIC has formed a preliminary view that a banning order should be imposed. It is an administrative procedure which ASIC can then use to deal with those whom it believes should no longer be in the industry if, at the conclusion of its investigation, ASIC believes that that is the case.

Senator COONEY—What if 889A was retained, including part (b), but then the person against whom the order is made can go off to the AAT or perhaps the new Federal Magistrates Court so that you get a separation of functions and separate bodies carrying out those functions?

Mr Freeman—It still would suffer from the defect which I see in the bill at the moment, and that is that it allows ASIC to shoot first and ask questions later, so to speak.

Senator COONEY—I suppose it is a matter of trying to balance off the vices. There is the vice of perhaps ruining somebody's business and the vice of having somebody deal with the public who is not fit to do so.

Mr Freeman—I agree with that. There is always a question of balance. I think that is something that the industry and ASIC certainly have been addressing, and have addressed reasonably well at the moment. The main point I would like to make there is that if ASIC forms a view that there is some risk to investors or consumers, that ASIC has other provisions available to it to take action quite separately from the banning order process.

As for the instances in which I have been involved where banning orders have been commenced, I suppose the furthest extreme in one instance related to conduct which had taken place three years prior to that; in other instances two years or one year. It has never been the case that the subject of a banning order hearing in which I have been involved has related to conduct which took place last week or last month.

Senator COONEY—So you get the feeling—wrongly, of course, nevertheless you do get the feeling—that it might be a penalty rather than a preventive measure?

Mr Freeman—During the course of a hearing when a client comes to me I explain that it is not punitive, it is not a punishment; it is something that ASIC will do if it believes it is necessary to protect the public. That is the principle that we remind the delegate of when we are at the hearing. In one instance in which I have been involved there was a finding of a contravention of a provision of the Corporations Law relating to trading on the stock market. Nevertheless, the delegate formed the view that that person ought not to be banned because it was not necessary to protect the public. What we were dealing with there was an isolated incident that had occurred a couple of years before. We were able to address it with the offer of further education on our client's behalf. There were other personal reasons relating to the client which perhaps put in context his trading on a particular day. So that is the type of opportunity we say should be given to people prior to a banning order hearing or a banning order being made.

Senator COONEY—If you had to explain to clients why an order had been made under proposed 889A(b), you could have some difficulty because there would be no real tests that you could apply. Is that right?

Mr Freeman—There is no standard of conduct which is set out in that part of the bill which mirrors provisions in the Corporations Law, which set out shortcomings which would then entitle ASIC to consider a banning order being made. But I have no doubt that that would come in through regulation, practice or court decisions.

Senator COONEY—But you would say it would be fairly rough to perhaps ruin somebody's business pursuant to regulations that have not been made by parliament, although I suppose parliament can disallow them. Have you read 889D(1)?

Mr Freeman—Yes, and that is about the change of circumstances.

Senator COONEY—I cannot quite follow that. Mine reads:

(1) ASIC may vary or cancel a banning order, by giving written notice to the person against whom the order was made, if ASIC is satisfied that it is appropriate to do so because of a change in any of the circumstances based ...

I am not sure what that word 'based' is doing there. Have you worked out why they have that word 'based' there?

Mr Freeman—I think that this is the first opportunity a person has to challenge the making of the banning order.

Senator COONEY—Does that sentence make sense though? Just reading that, I am not sure that it does.

Mr Freeman—It is probably superfluous.

Senator COONEY—I suppose it is if ASIC is satisfied that it is appropriate because of a change in any of the circumstances on which ASIC based the order.

Mr Freeman—Yes, it looks like that is what it should be. I do not think it adds anything and it makes it less clear. One assumes, at the time of being enabled to take advantage of that provision, that ASIC, apart from the banning order, which is really just a piece of paper saying that the person is banned, would also give the person some idea of the circumstances on which it has based its banning order to enable that person to see whether there have been changed circumstances. That to my mind is a matter of commonsense, but it is also a matter which is fairly narrow. It does not allow, on the face of it, a challenge to a banning order in the absence of changed circumstances. For example, if you just believe that ASIC got it wrong, that it is not infallible and that sometimes—

Senator COONEY—If the wrong person was appointed to head up ASIC, there would be real trouble—or there could be real trouble.

Mr Freeman—Yes. I have a high degree of faith in the way that ASIC discharges its functions.

Senator COONEY—That is because of the good staff it has now.

Mr Freeman—Yes.

Senator COONEY—It is headed up by a very good person, but if things changed—

Mr Freeman—That is right. My concern is that a right that we have in the statute at the moment is going to disappear and be replaced by a degree of uncertainty and possibly a degree of unfairness. If, under provision 889D, a person makes an application to vary the banning order based on changed circumstances and that is not successful, the person has an opportunity to have a hearing at that stage. But, again, it contemplates making an application based on changed circumstances first and it is not clear that if you accept that there are no changed circumstances, you just believe that a bad decision was made, whether you then have any right to a hearing at that point.

Senator COONEY—And you would say a court or another body would be able to make an order banning a person from going about his business very rapidly, but after giving that person a reasonable opportunity to put a case.

Mr Freeman—Not to ban them, I suppose. If ASIC believed that a person was contravening a provision of the Corporations Law, for example, it could get an injunction preventing that person from continuing with that breach and making some other practical orders—stopping them give effect to any breach that has occurred. That protection is still there as an immediate first port of call. The way investigations are conducted, as I understand it, is that ASIC receives a complaint, considers it—it considers whether any urgent action needs to be taken—then looks at any civil action that might be taken and, at the end of the day, determines whether there is any administrative action that needs to be taken to remove that person from the industry. So it is really the tail end of things that we are dealing with here.

Senator COONEY—It saves you having to tell a client that he or she has won the case, but the business has disappeared in the meantime.

Mr Freeman—The business and personal professional reputation too.

CHAIRMAN—Mr Freeman, thank you very much for appearing before the committee this morning and your extensive answers to our questions.

BISHOP, Mr Chris, National General Manager, Credit Management, Telstra

CARREL, Ms Sasha, Manager, Regulatory Policy, Telstra Retail, Telstra

COLLEDGE, Mr Greg, Executive Manager, Business Analysis; Finance Manager, Telstra Visa Cards, Telstra

CHAIRMAN—I now welcome the representatives of Telstra. We have before us your submission which we have numbered 27. Do you wish to make an opening statement in relation to your submission? If so, please proceed and then we can move to questions after that.

Mr Bishop—Thank you for the opportunity to address the inquiry. As indicated, those appearing represent the functional areas of financial services within Telstra Corporation. I lead the team as General Manager, Credit Management. I have responsibility for collections and credit policy for the organisation. What we would like to achieve today is to give Telstra's perspective on the reform bill and the government's policy goal, outline our interests in the financial sector, discuss the broad policy issues associated with the proposed legislation and our particular interest in the overlap with the proposed EFT code of conduct being developed by ASIC prior to and now in parallel with this reform.

The principal issue we wish to address is, for an organisation the size of Telstra, its support for one financial services regulatory regime and umbrella approach on a national perspective, but temper that support with some concern as to the operational implementation of the reforms and the compliance issues that flow from that operational implementation. There are some concerns as to the detail—as the saying is, the devil is in the detail—with respect to the definitional processes and the impact that that would have on a large national financial services provider such as Telstra in its emerging role. At the outset I would like to make it clear that Telstra's role in financial services is seen as an infrastructure provider primarily and potentially a content aggregator. We do not see ourselves as a prime player in relation to the provision of financial advice.

The key opening statement that we would like to reflect is that, in supporting the policy goals of the legislation and the need for one stop shopping—if we can use that term for financial services regulation in the context of the Corporations Law—we strongly believe that the approach needs to be regulation of an investment decision of a consumer, not regulation of a transaction related thereto. In other words, regulation of a financial product or financial advice that is provided to a consumer to assist in a decision of choice as to investment is certainly appropriate for umbrella regulation. Where the difficulty occurs is in implementation of that umbrella regulation in areas where the content of the investment decision or the conduit for which that investment decision is processed overlaps with the investment decision itself. What I mean by that is that transactions such as payments, operational access and delivery of products through a channel ought not to be regulated unless that regulation goes to the heart of the consumer protection associated with the investment decision or the financial choice the consumer is making.

When we use the term 'investment decision' we feel that the genesis of the legislation, building on that of the dealing in securities and insurance advice and in a financial advisory context, is absolutely correct. Where we have some concerns is the potential inadvertent catching of transactional and operational issues from the words of the legislation. If I may give a couple of examples of that, we are the largest trade credit provider in Australia in respect of non-interest charging credit. There is a choice made as to how you pay, what terms you leave your phone bill open for and what approach you have as to product choice and selection. Our concern with that is that the regulation needs to ensure that the transaction of normal trade credit—that is, acquiring a service from a single supplier—and paying for that service by means of the emerging opportunities through the Internet online or by choice through bill payment

mechanisms and collection of the moneys associated with that trade credit are not caught within the umbrella of the legislation.

As we understand the minister and the policy direction, trade credit in a policy sense is not intended to be regulated by legislation, but our lawyers tell us that until the exclusion of that trade credit is expressed in black and white terms in the legislation there is some doubt that trade credit could be brought back into the legislation's umbrella by virtue of the regulation making power and use of trade credit for domestic household or even business purposes.

The other opening point I would like to encourage some discussion on is that Telstra has been, through the industry association of SPAN service providers, involved in the development of a proposed new EFT code of conduct. That code of conduct is traversing similar ground to much of the area of the exposure draft bill. We are very concerned at the potential for overlap associated with the draft bill, which will be black letter law, and the EFT code of conduct, which is a self-regulatory model code of conduct. Indeed, in Telstra's position, a plethora of codes of practice are being developed under the Australian communications industry forum auspices for the management of a customer relationship with respect to credit management, for example, billing, complaint handling, compensation, privacy. All the like issues are being developed in a regulatory regime sponsored by the light-handed framework of a self-regulatory regime with a code of conduct of EFT to be implemented in business via contractual warranties. We have some concern that in areas of overlap we are uncertain as to which version we would be able to mandate for operations at the coalface.

In essence, we are worried about dual compliance obligations arising from the position of the EFT code as a self-regulatory regime if Telstra signed up to that new document, and the obligations to comply with the various codes of practice applicable in our industry which are traversing areas of financial services and also the issue of compliance of what we call 'front of house' staff in their ability to deliver advice to consumers and whether that advice constitutes personal advice, general advice or investment advice, which would be regulated by the legislation. We see it very much as an important implementation of the legislation that the overlaps between CLERP 6 and the EFT code be resolved before either commence and they be templated to commence in a logical sequence.

The final comment we would like to make is that throughout the Telstra submission and the consultative approach of this legislation, which has been most welcome, we have had a compliance goal in mind. We express some concern at the media speculation that the delay of the implementation of the reform's entry into parliament and finalisation as to the words will impose quite significant systemic and compliance costs on an organisation such as Telstra if we had to implement this legislation by an agreed date of, say, 1 January 2001, particularly when the systemic issues flowing from compliance check lists and staff training come on the back of Y2K, GST and very large systemic changes in organisations, and compliance with the ACIF code processes and the EFT code of conduct. If they all hit together, we believe that there would be a serious risk of operational dysfunction and non-compliance because of the obligations that have to be developed in parallel and also have to be changed at the last minute.

In summary, our principal concern is that, although we fully support the goals of the legislation and we fully support the position of one-stop shopping, we are concerned with the detail and its implementation time frame, particularly with respect to certainty of its application and to

what degree an organisation like Telstra would have to train its staff to a commencement date still spoken of in terms of 1 January 2001—unlikely to be that, one would assume—or 1 July 2001. Until the legislation is confirmed and the regulations are understood, The systems changes and the process changes are potentially horrific if we are in the arena of having to deal with training staff for personal advice, et cetera. I will hand over to Sasha to comment on the broad policy issues and a few points that we would like to highlight for discussion.

Ms Carrel—Telstra would like to see reflected in the bill five key points that, as Chris said, look at the broad policy level. Firstly, the regime should have very clear and workable definitions. As you would be aware, the regime is based on some very key definitions—at the outset, whether particular products and services are covered by it. Telstra, in its submission, makes some suggestions about how, on the margin, some of those definitions might be more workable, ensuring that there are no unintended consequences so that particular products—perhaps payments products—are brought into the whole regime only when there is no clear consumer protection issue at stake.

Secondly, there is a need to strike a clear balance between certainty for industry and the flexibility of the regime going forward. An example of the certainty for industry is simply which products and services are caught. In terms of flexibility, the issue might be how disclosure documentation will be applied to high value versus low value products. For example, the product disclosure statements, as I understand it, can have slight variations in the information provided on different products.

The third principle is that additional costs for business, in terms of disclosures or licensing structures, should reflect an increase in the consumer benefit. For example, information that is required to be provided has a material influence on their decision to acquire or to purchase a financial service, rather than just providing that information without that necessity.

Fourthly, as Chris was discussing, Telstra would like to see a clear relationship between this legislation and any self-regulatory mechanisms that end up catching this very broad coverage of different products and services. We have made quite detailed comments about the EFT code,.

The last point, and quite an important one, is that the whole perspective of the bill recognises the potential of convergence and online delivery of financial services in terms of how the business models for delivering those services can be quite different from those we have experienced to date in the off-line world, through financial advisers and things like that, so that you have got some issues to deal with in terms of the requirements and how they relate to a consumer clicking through a process versus what we might understand to be the way that has been delivered in the past. I think that sums up those principles.

Mr Bishop—Finally, Telstra is, as you no doubt would be aware, at the forefront of convergence in the e-commerce environment, and it is probably no surprise that we have a financial services area. Greg Colledge comes from that area and he is charged with the interesting task of plotting the path through the convergence of e-commerce and traditional old and new economies in the delivery of products.

We are embracing convergence, aiming to be involved in more and more activities in the financial services sector, particularly in the on-line environment. One of the interesting and

problematic positions is what financial services is today and what it is going to be in three or four years time. One of the areas of focus of both the legislation and the EFT code is the degree of necessity to regulate the so-called smart card market—multi-application smart card, the new technology server, web wallets and all of these new delivery mechanisms for financial services—at this point in time when the market is not mature along those lines . This causes some concern to all industry, in the sense that if we have black letter law that discourages innovation in the technology area, it will be disadvantageous to embracing e-commerce.

So, at the crossroads of conversion of the old economy into the new economy, the delivery of traditional telephony services through other distribution channels, in particular on-line, and the aggregation of financial services for strategic alliance or joint venture partners are areas of particular interest and challenge for Telstra—hence our concern that Telstra might be seen as a peripheral play and not a mainstream financial services provider. Our concern is to ensure that there is high-level regulation but not prescription in order to allow the e-commerce framework to develop, particularly in the area of business-to-consumer—and this is where this legislation is aimed at. Business-to-business e-commerce is developing and thriving, but it would be fair to say that business-to-consumer e-commerce is still waiting for the critical mass to take up. We are concerned that if this legislation and the self regulatory codes, including the model for e-commerce developed at a national level, do not dovetail, we run the risk of having operational dislocation and not achieving the best out of the so-called new economy in cyberspace.

CHAIRMAN—Thank you Mr Bishop. You have nothing to add at this stage, Mr Colledge?

Mr Colledge—No. I think everything I am hearing at this stage is that we need to ensure that the intent of the legislation is actually embodied in the final black letter.

CHAIRMAN—I note from what you have said and from looking at your submission that you have got concerns regarding the definition of financial products and the definition of financial advice. Are those concerns linked to this concern you expressed about trade credit being caught up in the legislation, or are they broader than that?

Mr Bishop—They are broader than that. It is a stepped issue. If trade credit were included, it would be a different compliance regime and there would be a different approach to it. But in the pure or traditional financial services areas, where some of the definitions could lead to Telstra, as an infrastructure provider, providing mechanisms for a consumer to make a decision—issues like which payment mechanism do I adopt: direct debit, Bpay, Australia Post—if the financial services definitions of what constitutes a financial product, an investment decision and a financial service are not clear as to where the boundary is crossed over, you run the risk of a simple payment transaction being caught up in a requirement for a disclosure statement, potentially individual personal advice and general investment advice. That is where the concern is: in the demarcation flowing from what the policy intent is and how it is articulated in writing.

The trade credit issue is a particularly significant one because the lawyers tell us that clause 763D(2)(b)(ii) is the vehicle. This is a payment facility that is a non-cash payment. The intention in relation to that is that if there is a non-cash payment for a payment facility relating to a number of persons, then that should be subject to the umbrella control. In other words, if you are what we call third party billing or securing payments for parties other than the supplier, then that is clearly within the ambit, but if it is a single payment or a payment to a supplier for the

provision of gas, a utility, electricity or telecommunications, a trade credit as we call it, to a single supplier, that should clearly be expressed as being excluded from the legislation.

CHAIRMAN—Your concern is that as it is drafted at the moment, it may be included?

Mr Bishop—Yes. Our lawyer's concern is that it is not excluded and therefore it potentially can be included by a process of regulation or uncertainty.

CHAIRMAN—Because if it were going to be included for you it would be included for virtually every business in Australia that provides trade—

Mr Bishop—As the minister's office and Treasury have indicated to us unequivocally, the policy intent is not to regulate day-to-day consumer credit through trade credit where there is no investment decision or interest component. However, all the lawyers are saying that that is the policy intent but it is certainly not reflected in the present drafting of the legislation, and the means to achieve that would be an amendment to include the exclusion of trade credit expressly within the exclusory provisions of the legislation.

CHAIRMAN—Have you raised this with Treasury?

Mr Bishop—Yes, we have, and they are looking at it. They are sympathetic to the view we have. Our concern is the truncation of time.

CHAIRMAN—I understand. Can I take you back to these other two definitional issues? We have had extensive concerns expressed to us about the potential impact of the definitions in relation to counter staff such as tellers and bank clerks and so on in relation to the banking industry.

Mr Bishop—We reflect those concerns for our front-of-house staff.

CHAIRMAN—I am wondering how you see yourselves. They are obviously a financial service provider, but what I am trying to get my mind around is how Telstra regards itself as getting caught up in the web of a financial service provider. Obviously, you provide infrastructure for financial services to be conducted, but what is your fear? Is it that you are going to get caught up as a provider?

Ms Carrel—There are two points. We raised in our submission some information on our e-commerce products which basically go as far as facilitating the electronic messaging. They facilitate a transaction from a consumer to a financial institution. It may be an end-to-end service but Telstra is in no way handling any funds or entering the banking system in its own right.The issue was raised about how we may inadvertently get caught up in, for example, providing financial advice. Our front-of-house people discuss with customers various payment options in terms of telecommunications services—for example, mobile phone plans—and particular up-front payment cards. If that particular payment option were caught under CLERP 6, I think there could be bit of discrepancy about whether we were actually providing them with advice about that payment option. Although we would not be getting a commission, the way the legislation talks about remuneration to the licensee it could mean that if, for example, Telstra had an arrangement with a particular payment option, such as Telstra Visa Card—which is not a good

example because the Visa card would not be caught by this regime—or, for example, a smart card scheme that was caught, I think there may be a concern about whether we were intending to potentially influence a customer.

Clearly, the intent of the whole service is a telecommunications service. That is the underlying service. The issues paper raises the issue of there being additional limbs with respect to the definition of financial investment—for example, where the actual underlying aim of the transaction is not to make a financial investment, if there is another reason for it, perhaps it is not included. We are a little concerned that discussing payment options that are covered within the regime could fall within this financial advice provision, which would obviously be quite a shock to the industry. I do not think, from speaking with Treasury, that it is the policy intent. But it would be good if that sort of thing was explicitly cleared up as well as there being a clear demarcation between what is facilitating a financial service in terms of electronic messaging, et cetera and a provision for intermediaries perhaps where we do not have the right to debit a consumer's account and we do not control their funds—we are just the messenger, if you like.

Mr Bishop—That is a key distinction between a content provider or the provision of the actual service and the means of achieving that or executing the transaction. Our front-of-house concern is that if someone rings up and says, 'I owe $2,500; what is the best means of me paying that?' if Telstra says, 'Well, Bpay or direct debit are options for you,' and we are influencing the decision of the consumer because our cost of operations is much cheaper by direct debit than Bpay, for example, we could inadvertently be caught up with the scenario of our front-of-house counter staff providing financial advice to a consumer. I do not believe that was ever intended, but when you have the means of delivery of the transaction passing through an intermediary—which we are in that context—we run the risk, if we are seen as providing a financial service, of being caught by the obligation to provide all the disclosure. The definitions are so general and vague in some places that, in many cases, our lawyers tell us that, in day-to-day transactions, we could be seen as providing a financial service and providing personal advice, particularly to a consumer in difficulty, for example, who is unable to pay their bill. If we do a work-out proposal and send them to a financial counsellor, those sorts of issues could very much trigger a provision of financial service advice and require us to do the compliance obligations.

We would like to see it made clear that an infrastructure provider piggybacks on the licensing of the financial services content provider and is insulated from the pass-through position of risk in tripping up some of the disclosure obligations or advice and can rely unequivocally on the financial service providers regulatory regime. The market is already addressing that. Of concern in separating legal entities—who is providing what advice, joint ventures et cetera—it needs to be made very clear who has the prime obligation to provide the licence, provide the disclosure regime and undertake compliance with the legislation, whether it be the end provider of the financial service—the product advice or insurance in that situation—or whether it be all parties in the chain.

CHAIRMAN—Do you have proposed definitions that would meet the intent of the legislation without having this unintended consequence?

Mr Bishop—Yes, our lawyers have put some suggestions—

CHAIRMAN—Was it in the submission?

Mr Bishop—No. I think it was in the original discussions and appearance with Treasury. I am not sure we have extracted it in the submission.

Ms Carrel—It is something as simple as having an overriding clause. It is almost incidental information on a payment option, because I think in all these cases when there is an underlying service it is simply a payment option. It is not going to be an investment or anything else. Basically, that is not seen to fit within the definition of financial product. It is really when there is an underlying service. Obviously, if an organisation is providing financial advice about financial products for the sake of it, that is quite a different story than simply having to discuss payment options about an underlying service. It is a fairly general comment, but we are quite happy to come back with a suggestion in writing if that would be welcomed.

CHAIRMAN—That would be useful.

Mr Bishop—I am aware that the Law Council of Australia and the Law Institute of Victoria have similar concerns for their members, as solicitors, incidentally providing financial advice that could be caught by this legislation. The concept of an exemption or exclusion from the legislation of provision of financial advice incidental to the delivery of financial advice on behalf of some other person—that type of context—could take it out of play.

CHAIRMAN—You expressed your concern about potential for inconsistency between the legislation and the electronic funds transfer code. Could you outline where you see the potential inconsistencies?

Mr Bishop—I am a member of a working party for developing the EFT code. There has been some robust discussion in that arena as to the chicken and egg principle. The potential area for conflict predominantly is in the non-cash payment facility arena being described as a financial product. Part B of the EFT code is being developed to provide a self-regulatory regime for smart cards. Part A of the code is to extend the existing EFT code, which applies to the provision of a financial payment, or electronic funds transfer involving a card and a PIN, to all transfers of funds through a device.

In that scenario there is the Telstra pay by phone facility. For example, if you want to pay your telephone bill by phone, you ring up and punch in the details and your credit card number and pay by phone. It has exponentially taken off as the choice of consumers wishing to do that—associated with frequent flier points, I am sure but, nevertheless, that is what is happening. Our concern is that that particular transaction has the potential of being regulated under the communications forum codes of practice, the EFT code and the CLERP 6 legislation. It is those areas of absolute clarity of where the umbrella applies and where the EFT code applies which are important.

In the context of the EFT code, there has been a very convoluted and complex definition of biller accounts to try to take out of play in the EFT scenario an account which is intended to be paid to a single supplier. The words do not marry up precisely with the provisions regarding a payment facility that is a non-cash payment if there are restrictions on a number of people. That

is where we are concerned to ensure that the windows align totally. Our point at the moment is that we do not believe they do.

Ms Carrel—In our submission from pages 27 to 30, we have a table on some of the specifics, particularly disclosures that clearly would be impossible to comply with for that subset of products in terms of, for example, time frames within which disclosures need to be provided to consumers, et cetera. As I mentioned at the outset, what we are after, whether it comes from the EFT code or from this legislation, is a clear understanding of exactly what supersedes what and what Telstra needs to be working into its business plans about the fine detail of what is intended to be covered.

Mr Bishop—In that regard I do not want it to be inferred that I am criticising the ASIC process for development of the code. They are consciously aware of this overlap coming out of the left field and I believe they are working with Treasury to try to get common ground. The difficulty that institutions like Telstra are having is that there is a push to get both of these initiatives up. It is a chicken and egg. If they are not completely aligned, the cost of having two compliance regimes would be prohibitive. So that it could lead to institutions saying, 'We don't wish to adopt a self-regulatory regime. We will wait until the black-letter law is final and then move down that path.' That, to me, is the single most urgent need, to clarify when these initiatives are going to occur in tandem, if they are in tandem, to remove the misalignment, as we describe it.

CHAIRMAN—In that context, it might be appropriate to draw your attention to the inquiry that this committee has commenced into electronic banking. In particular, it is looking at the current degree of electronic banking and what might be appropriate levels of transparency of electronic banking fees. It is also looking at the reasons for the increase in fees over the last couple of years, which arose out of the exclusion at this stage from the EFT code of the up-front disclosure of fees on ATMs. I am sure the committee would find it worthwhile if you felt able to make a submission to that, given your technical expertise and so on. We can provide those terms of reference. I do not know whether you are aware of that inquiry.

Mr Bishop—Yes, we are. There are more reviews than hot dinners in one sense. There is the joint RBA and ACCC review of interchange fees and there are crossovers between that as well. We are planning to respond to that in tandem.

CHAIRMAN—We would welcome a submission from you if you are able to do that in the near future.

Senator COONEY—I can understand the apprehension about being regulated when there is no need for it, particularly in terms of the front-of-house people. I was just looking at the appendix and some of the issues in your submission. Point 4.5 deals with client money and it goes on to the expanded EFT code of conduct and Telstra e-commerce products. Do the front-of- house people ever tell consumers about these matters, in particular about the Telstra e-commerce products? If I got in touch with your front-of-house people, would they just simply answer my inquiries or would then proffer other products?

Mr Bishop—Senator, we would hope they would, what we call, cross sell. The reality is that we are very conscious to script the response to the customer's inquiry, so there is not a shopping

list of items to try to tick off and persuade the consumer to acquire. But in response to a consumer's inquiry as to available products, there will be a general response. That is where the concern will arise. A telephony product, associated with a plan for a mobile phone that has a payment choice associated with it, could well be seen to be providing that cross sell, up sell, advice to the benefit of the company to secure a commission from its partner that delivers the on-line insurance services or a banking service. In that sense there is a clear delineation where we currently require the front-of-house staff not to go beyond their level of response to the consumer's inquiry. But it is a very grey line of when an answer to a question becomes, 'Yes, have I got a deal for you' response.

Ms Carrel—Can I just make one point that is worth noting. Increasingly, Telstra is trying to use its online channel through its main portal Telstra.com and within that consumers can basically find all the online products, including these e-commerce products or the traditional telephony products. So in that sense there is no person there at all and what you have is a lot of information and obviously terms and conditions of joining up to an e-commerce shopping facility, et cetera. That is just an example of how some of the issues that have attached themselves to one person actually advising another has changed in that scenario.

Senator COONEY—So I take it that the three of you are telling me categorically that no front-of-house people would ever suggest that there are products which Telstra may have available which would be of advantage to them? Can I take it that that is what you are saying?

Mr Bishop—Are you talking about investment and advisory products?

Senator COONEY—No, any products that would be of advantage to them.

Mr Bishop—No. We would be hoping that they would cross-sell Telstra's products but not influence an investment decision in relation to a financial product. For example, we would point them to an online service or a Telstra-Visa card or any of the available electronic options through Telstra.com but there would not be a focused hard sell of other products that are non-Telstra.

Senator COONEY—Is there any obligation on the front-of-house people to tell potential customers or consumers that there are products which Telstra wants?

Mr Bishop—No. Not an obligation in the sense that the front-of-house staff in Telstra are responding to an inbound call in a general sense and that is a customer is after some information or a service. It will respond to that but not, say, take an initiative and checklist of 10 products—'Have I cross-sold insurance or superannuation?'

Senator COONEY—So there is no list that Telstra front-of-house staff have where they have to say, 'We've mentioned these products of Telstra.'

Mr Bishop—No.

Senator COONEY—I think that the union that looks after the people that work at Telstra was using the word 'slamming' at one stage. You are saying that no slamming takes place. Is that right?

Mr Bishop—No slamming takes place. There is a policy in relation to no slamming. Slamming has been a particular industry problem that is being addressed. The context that you are talking about is when someone says, 'I want to save costs on my phone bill. How do I get my phone bill down?' Naturally a staff member will say, 'Are you aware of our $20 or $30 plan?' or something of that nature and discuss with the consumer the options to reduce the particular telephony usage. Then they will be selling a product or, in the television advertising, a $3 special for ringing—'Do you do a lot of international calls? Perhaps you can use this plan to improve your benefit.' That would be cross-selling Telstra's products.

CHAIRMAN—What you are saying is that what they are selling there is a telecommunications product, not a financial product.

Mr Bishop—Correct.

CHAIRMAN—But because it has some financial implications, it might get caught up in this definition of a financial product.

Mr Bishop—Precisely. You put it much better than I did.

Senator COONEY—I was just wondering why the legislation is as it appears. When you talk about convergence, I suppose a legislator might say, 'There is financial advantage to a provider here.' You would get to the point where matters become grey and then it tips over. If you want to make sure that the consumer is protected, I suppose you have to perhaps err on the side of strictness almost.

Mr Bishop—That is correct.

Senator COONEY—What Telstra was saying was, 'This makes it difficult for us to operate.' Again, what we are dealing with here, I suppose, is a balance of vices—what is going to be worse? Is it worse to impose a bit more trouble on Telstra to avoid people being financially disadvantaged?

Mr Bishop—We support the principle of full disclosure and truth in financial services—there are a lot of truth-in-lending principles. However, Telstra is subject to its self-regulatory regime. We have a prices, terms and conditions code of practice which requires full disclosure and information for consumer choice when making a decision in relation to a product, particularly as to pricing, advertising content and the benefit. That regulatory regime was developed between our regulator, consumer groups and the industry and we have a compliance capacity for that. It traverses the same ground. In essence, we are already regulated in that. There is no market failure evident associated with systemic failure at a high level. Of course, there are complaints at an individual level. The telecommunications industry is now moving to a pretty extensive suite of codes of practice which cover the same ground as the EFT code and cover the same ground as this legislation.

We are effectively saying choice of black-letter law or codes is on a collision course to the degree where we are getting to the stage of inconsistency between the two. You run the risk of dual regulation. We agree that where there is an inequality of bargaining power and a potential to influence a consumer to make a choice if it is an investment style product it is appropriate for

umbrella regulation. If it is an industry specific, telephony style product, we believe we are already sufficiently regulated by the Telecommunications Act and the codes.

Senator COONEY—The point you make about the overlap is a point that has arisen before; so it is not unique. It then becomes a choice. I would be interested to hear what you have to say about whether the choice should be in terms of the legislation—the black-letter law, as you say. In a sense that gives the consumer much more protection.

Mr Bishop—True, but I do not think the self-regulatory regime has been given sufficient time to work. These are new initiatives that have been developed in tandem at 100 miles an hour. All industries are trying to meet that self-regulatory regime until it is established that it is insufficient protection. That is why we believe in the grandfathering of the legislation for two years, to say, 'Yes, it comes on to the books, if that is the government's desire.' Its compliance can be via the self-regulatory codes. In addition, until those self-regulatory codes have bedded down, we ought to have a position of single compliance for a period of one to two years. That is our general preference.

Senator COONEY—You say that business to consumer e-commerce is languishing, whereas business to business e-commerce is flourishing—

Mr Bishop—I did not use the term 'languishing'. I think it has not taken off yet.

Senator COONEY—It has not taken off yet. I just heard a news item—I am not sure where—which said that e-commerce in Australia had not had the response that it has had overseas and other places. Do you put that down to regulation?

Mr Bishop—There are three issues: the uncertainty of a regulatory regime, the consumer's correct concern of privacy and the issue of security of online transactions. It is a mix of all three. Would you agree with that, Greg?

Mr Colledge—Yes.

Senator COONEY—I had better put in that context an opportunity for you to answer again because those could be provided by black-letter law, whereas a self-regulatory regime would not be sufficient to convince the consumer about the safety of e-commerce. Would you like to respond to that?

Mr Bishop—The national privacy principles, being an example, were put together by industry consumers and the regulator. As I understand, the new federal privacy legislation is very much predicated upon self-regulatory codes. If they are not working or adopted, then black-letter law applies. We believe that regime is appropriate. It is consistent with the telecommunications approach—I do not know how many pages of legislation there are in the Telecommunications Act, but it is several thousand—of trying to make industry make it work through codes of practice which have sanctions, flow through compliance, and ombudsman type compensation schemes. We believe that is a preferable model and less prescriptive, because industry are at the table developing it, than black-letter law.

Senator COONEY—Some of the problems, especially with privacy, are about whether or not it suits the European Community in particular. Do you know that argument?

Mr Bishop—Yes.

Senator COONEY—I will not get on to that because we are on this issue at the moment. The last point I want to raise is the matter that the chairman has already raised. You said that the definitions that underpin the act are very important because if they are not made explicit then the proposed act becomes much more troublesome. Were there any particular definitions that you had in mind? This is a matter that has been raised before.

Mr Bishop—If I can address the three specifically, credit is a generic term. As I understand the provision, section 765A(1) is a vehicle to take credit out of play. It says 'specific classes of things that are not financial products'. The definition that flows from there, if credit was excluded from that, would be the means of clearing that particular issue up.

Senator COONEY—So it is 765A(1); it is the definition of financial products.

Mr Bishop—What are not financial products. The provision of trade credit, if that were appearing there, would make it unequivocal, but that was excluded. As to the areas that Sasha averted to, I believe she can take them up as to personal advice and general advice.

Ms Carrel—Yes.

Senator COONEY—Sorry, but just before you start: advice has been the one issue raised the most.

Ms Carrel—Yes. Basically, our position on the definition in its broad sense is that it is too broad covering off what is intended to influence as well as reporting on those matters et cetera. It does not clearly indicate, for example, when one is providing financial information. It does not demarcate exactly what that might be. I go back to the online environment once again. As you would be aware with the business models on the Internet, a lot of financial services web sites may not ever provide advice. They can break that service right down to simply providing you with a lot of information. Is that going to be considered to be reporting interpretations that are 'intended to influence'? That is the key point. 'Intended to influence', simply as it is worded, may need some more fleshing out in terms of some examples of what actually constitute that for it not to curtail the sorts of new activities that we will be using particularly in the online environment.

Senator COONEY—Mr Bishop has raised the problem with the issue of business to business transactions taking off in e-commerce, not with this other one. The difficulty is with what the consumer may find, and it is just speculation. I say that because we have not had any consumers in—at least I do not think so. Have we, Chairman?

CHAIRMAN—No.

Senator COONEY—It is that you ring up and you have things told to you by a front of house person who, by definition, is not going to be as well acquainted with things as somebody

further up the line. The consumer acts on that and then people say that that was the wrong advice. I think there might be too great a readiness just to say, 'The front of house person is the person that is pursuing his or her career and it is very difficult for a business to accommodate all that you would want.' The sorts of people that people would like on the front counter are the sorts of people that you would have running the company; nevertheless, the consumer is affected by all that. So you would have to have very strict limits as to what the front of house person could say. If you had strict limits on that, how do you think that would go as far as the business itself is concerned? You have a person who is very restricted as to what he or she can say, and that is going to affect the sorts of things you want to tell people about, because if he or she goes further or makes a mistake, then you are caught.

Mr Bishop—That is very much a compliance issue. That would be the direction that Telstra would follow—strict scripting—and, if there is an inquiry as to the element of the financial product, to point them to the content provider of that financial product for advice relating to it. In other words, it would be made absolutely clear that if the customer is seeking a Telstra solution, they would be advised in respect to that but it would not go beyond that advice or discussion of a customer's needs into the provision of financial advice.

Senator COONEY—What was the third point? You have given us two.

Ms Carrel—In terms of other definitions?

Senator COONEY—Yes.

Ms Carrel—The clearance and settlement facility has not been raised this morning. That definition talks about meeting the obligations of parties in a particular transaction. From speaking with Treasury, the policy intent certainly is that a clearance and settlement facility must physically settle funds in an account. For the sorts of e-commerce back-end systems we were discussing earlier, Telstra would like to see that a little more explicit in terms of once again facilitating that ultimate settlement that happens through others is not borne out in the definition. I think it talks about if there is an actual participant in a clearance and settlement situation then you can meet the obligations and be exempt. But if Telstra was not a participant in that clearance and settlement facility in the transaction I do not think it is clear. Certainly, that whole regime is quite major.

Mr Bishop—There are two other areas of significant threshold concern, the retail-wholesale client distinction.

Senator COONEY—That has been raised too.

Mr Bishop—And the incredible breadth and width of the term 'dealing'. 'Dealing' in a financial product does trip-wire some of that incidental provision, particularly financial product advice, as we have described. The retail-wholesale client distinction is absolutely critical to large organisations which segment their book into consumer and business. Being able to identify who is a retail client, who is a wholesale client, who is a consumer client and who is a business client could mean many millions of dollars in systems flagging and development if they are not aligned across the board.

Ms Carrel—Certainly, having the onus on an organisation to ascertain that may not be the best option. Perhaps there could be some more detail in terms of a retail client not being able to resale, for example—some more flesh on the definition, if you like, rather than the onus being back on the organisation to classify that client.

Senator COONEY—They are major matters. There may be others, but we do not want to bind you down now. From what you were saying, Mr Bishop, by the time they are all sorted out, 1 January might be upon us.

Mr Bishop—Yes.

CHAIRMAN—If there are no further questions, Mr Bishop, I thank you and your colleagues for appearing before the committee this morning and for answering our questions.

[11.33 a.m.]

JONES, Ms Christine, National Manager, Market Law and Policy, Australian Stock Exchange

SHAW, Mr Alan, National Manager, Supervision, Australian Stock Exchange

CHAIRMAN—We have before us your submission, which we have referred to as No. 46. Do you wish to make an opening statement in relation to your submission?

Ms C. Jones—Yes, thank you. The CLERP proposals are, of course, very significant to the Australian Stock Exchange, so we do have an opening statement which we hope is not going to be too long for you. ASX has been an active participant in the CLERP consultative process since its inception, and the committee has received both our long and our short form submissions on the reform bill, which is the focus of today's hearing. ASX believes that the bill implements a number of significant regulatory reforms and would like to emphasise today a few issues which were addressed by the proposed reforms which we believe are vital to the positioning of Australia as a global financial services centre. We will touch on those shortly.

First, I would like to make some more general observations about ASX's role in the financial services industry and our support for the reform process. The capitalisation of our market, counting domestic stocks only, is now approximately $655 billion. This is approximately four times what it was a decade ago. Our trading volumes have grown just as rapidly over this period by some 350 per cent, which in turn has led to steady growth in one of the most important competitive features of market—that is, its liquidity.

Much of the increase in trading activity can be attributed to the growth in the number of retail investors. Approximately 7.6 million Australians, or 54 per cent of the adult population, now own shares. This is an increase from 38 per cent in 1997. However, about 62 per cent of those shareholders own three stocks or less, 55 per cent of those shareholders either did not trade or made just one trade in the last year, and shares still only account for 13 per cent of funds invested. So investing in shares is still a relatively new form of investment for many retail clients. Putting this into the international context, our equities market is relatively small even though the Australian stock market is the 12th largest national market in the world by market capitalisation. In the MSCI World Index, which is widely used as the basis of asset allocation by international fund managers, Australia accounts for approximately 1.12 per cent. By way of comparison, the United States accounts for more than 50 per cent and Europe accounts for about one-third.

To continue to grow and remain relevant, our markets need to be able to respond quickly to change, domestically and internationally, and our regulatory framework is a key element in our capacity to compete effectively. These reforms are therefore welcome. ASX has been an active supporter of the process designed to contribute to the efficiency of the economy while maintaining investor protection and market integrity. We believe that the key concepts of a single licensing regime, harmonised regulation and a recognition of the different requirements of professional and retail investors, are sound building blocks for this.

However, in the context of our CLERP 6 submissions, we express concern that overall there is an increase in the amount of regulation of the financial services sector and about the impact of such an increase on the level of domestic innovation in the financial services marketplace. Our size in the global marketplace means that we cannot afford inefficiencies in the framework governing the delivery of financial market products and services. We need this for its own sake in the regulatory arrangements. We need to be sure that the level of financial markets regulation, which is the package of regulation, including Corporations Law, trade practices law, taxation, contract law, et cetera—not just the reforms that we are considering today—best promotes market confidence, best facilitates the choice of Australia as a centre for financial market operations and equips our financial market participants to compete internationally.

We note that the FSR bill takes a light approach to the regulation of foreign based markets which may operate in Australia, less so than for domestic markets or clearing and settlement facilities. This may partly be a drafting problem, the way in which the international market and clearing and service facilities are drafted. But if it is not a drafting problem and is an issue of policy, there is a risk that the regime that CLERP 6 proposes to put in place for foreign markets will hamper onshore facilities and not properly protect Australians having access to offshore facilities. Conversely however, if you are Australian or Australian incorporated, you will be regulated under the Australian regime regardless of whether or not you operate in Australia. This could give incentives for offshore incorporations and operations.

A key principle of the reform agenda is cost effectiveness. The benefits of business regulation must outweigh its associated costs. The level of regulation is not diminished by the FSR bill. There are many components where, in fact, there is an increase. The regulation of markets and clearing and settlement facilities is substantial and is greater than it currently stands in the law. Other examples of where regulation has increased include: over-the-counter markets are now required to be licensed unless exempt; there is a requirement for clearing and settlement facilities to have in place procedures for resolving complaints; the external complaints resolution scheme for financial market intermediaries has been extended; the use of product disclosure statements requires broader disclosure than was previously required; and markets are required to decide if end users will be retail in order to know which regime they must comply with. Some of this additional regulation may well be warranted, but the point is that it simply adds to an already significant amount of regulation. What we have not seen is where there is a commensurate reduction in regulation as not being warranted, although the single licensing regime may deliver in this regard.

There are also areas where it is unclear how much regulation there will be because the level is being left to ASIC or to the regulations, which are still being drafted. That said, however, we believe that the FSR bill delivers some fundamentally important reforms. In our submissions on the bill we have concentrated on providing constructive commentary with a view to making the legislation as robust and forward thinking as possible. As I mentioned earlier, there are a few features of the bill about which we would like to make some specific comments and explain why in practical terms we believe they are very important.

The first matter is the co-regulatory model. Ever since the introduction of securities legislation in the early 1970s the Australian model for stock market regulation has been one of co-regulation. That is a combination of statutory and self-regulation. It is designed to achieve a productive collaboration between the government regulator and the self-regulatory organisation,

in this case ASX, with its special expertise and proximity to market. Corporations Law includes strong self-regulatory emphasis, placing primary responsibility for regulation in certain areas on the market regulator. Securities markets are rigorously regulated currently under chapter 7 of the law. In addition, ASX has very substantial rules which complement the requirements of that law. The rules are enforceable not only on a contractual basis but under sections 777 and 114.

We believe that the coregulatory framework has served Australia's financial markets well and should continue. Our understanding is that the government does too. We have received the minister's assurance that it was not the intention of CLERP 6 reforms to change the balance of the relationship between ASIC and the exchange or to increase regulation on markets. We recognise the specific and very significant responsibilities with which we are entrusted. Indeed, we consider the fulfilment of these as the key to the success of our markets and to the value of the ASX brand. We believe that it is fundamental to the co-regulatory framework that the minister remains involved. This is because of the broader economic and policy focus that the minister and department can bring to bear on regulatory issues. This in no way denies ASIC's role. We have given support to powers for ASIC to audit the supervisory functions of the exchange. But when CLERP was launched it recognised the need to promote business and economic development and this will remain essential on an ongoing basis.

We would now like to turn to a couple of specific areas. The first of these is the compensation arrangements under the bill, on which we have made some fairly detailed submissions and suggestions. In relation to the general compensation framework for retail investors we believe that it will be unnecessarily complex, giving rise to confusion of investors as to the right avenue of redress and to issues of market costs and efficiencies. Under the bill, compensation arrangements will need to be in place for each market operator, each financial service provider and each clearing and settlement facility that deals with retail investors. There will be considerable overlap, which is likely to be exacerbated in the future when financial service providers become participants in multiple markets and potentially multiple clearing and settlement facilities.

In addition, under the bill there are two different types of compensation arrangements proposed for markets and clearing settlement facilities, division 3 and division 4. Division 4 is intended to replace the existing arrangements, which cover the National Guarantee Fund, which is the investor protection rate currently in place for the Australian Stock Exchange and its brokers. ASX has submitted that a more streamlined framework is appropriate and could be achieved by promoting as far as possible a single minimum standard for division 3 and division 4 arrangements. This would not preclude additional protection, which could be offered by markets as a matter of commercial judgment. We have also submitted that there is no regulatory benefit that is not outweighed by cost in requiring clearing and settlement facilities in addition to the markets and market participants to have compensation arrangements of the type proposed.

Clearing and settlement facilities have to be licensed under the new regime. They will be subject to both initial and ongoing legislative requirements, including the requirement to reduce systemic risk and to have sufficient resources to properly operate the facility. ASX believes that these protections against the potential effects of failure of the participant in the system are the appropriate type of protection for clearing and settlement facilities and that protection of retail investors at an individual level is more appropriate to the financial service providers who have that relationship with the client and perhaps to the market operators. Currently the clearing

guarantee, which is critical to the reduction of systemic risk for ASX clearing houses, is provided by the National Guarantee Fund. This brings us to our second point: the separation of the clearing guarantee component from the fidelity component of the national guarantee fund.

A very important aspect of the bill to us is the proposal to restructure the NGF provisions, and we thought it would be useful to outline why we think it is important in the international positioning of our clearing houses. The National Guarantee Fund currently has a twofold purpose: it provides a central market clearing guarantee for our clearing houses, and it also provides a fidelity fund for protection of individual investors. Over time, these two purposes have diverged. The central market clearing guarantee is a key component in the overall attractiveness of the Australian marketplace to investors. It exists as backing to the financial stability of participants and has just noted that its purpose is the minimisation of systemic risk. Currently, the NGF arrangements are unique in the world, and they are quite difficult to explain to foreign market participants who might be considering entering our markets and for whom, of course, the stability of our clearing system is a very key consideration.

Some of the unique features of the National Guarantee Fund are that access to capital backing for the guarantee can only happen through statutory heads of claim. This is an administratively cumbersome and inflexible process. That is particularly damaging, I suppose, if you are faced with a crisis, because it is going to be very important to be able to react instantaneously to cover any failure so that no ongoing effect is felt. The second is that the separation of the operational risk management in the clearing house is separate from that capital backing. So the clearing house that manages the day-to-day operational risk for its participants and for the system is different from where the money actually comes from that would be called on in the event that there was a default by any individual participant in the system. The third unique feature is the mixing of funds which support the fidelity arrangements for the individual client protection measures.

ASX believes that the clearing guarantee needs to be enhanced and that the best means to do so is to bring the guarantee more clearly under the control of the clearing facility and to add an insurance layer above that currently available. That insurance would provide additional coverage, but that is not currently possible because, as I mentioned before, of the separation of the level of operational risk management from the provision of the capital guarantee. That makes insurers very uncomfortable. So, under the current arrangements, neither the clearing houses nor NGF are able to obtain this additional level of insurance.

The Financial Services Reform Bill addresses these concerns by providing that the minister may determine to pay out of the NGF to a clearing house an amount for the clearing guarantee. We are intending to seek the minister's approval for this step and to supplement any amount paid by taking out insurance. These arrangements will bring us into line with international practice and will generally enhance our ability to compete internationally.

I would like to touch briefly on the five per cent limit which currently applies to individual shareholdings in ASX as a demutualised entity. As stated in our submissions, ASX believes that the factors which prompted parliament to impose a five per cent shareholder limit on ASX are not confined in their application only to ASX. We have submitted that the limit, if that concept should be retained, should be increased to 15 per cent, in line with that applying to the banking sector, and that a larger share ownership should be permitted, subject to disallowance if fit and

proper criteria are not met. It is probable in the near term that the funds of millions of Australians will be invested either directly or indirectly across a range of markets operated by various commercial companies having potentially a range of ownership structures. Collectively, these organisations will form the core of Australia's capital markets and contribute to the efficient operation of the economy. To provide structural restrictions on one type of market operator—or, in this case, one particular market operator—without ensuring that they are necessary to achieve the regulatory outcomes and are evenly applied across the market licensing provisions, does not promote an even-handed competitive environment.

To turn now to part of ASX's supervisory role, an important aspect of that is the ability to provide information to the commission. Proposed section 104A gives ASX qualified privilege protection for information given to ASIC where it is required to do so, and of course we support this. However, there may be other actions—for example, under the Trade Practices Act—to which ASX is exposed if it volunteers information to ASIC. For regulatory purposes from time to time, we may consider that that is the most appropriate course to follow; however, this would expose ASX to various litigation risks. In our submission we have requested a more general statutory defence along the lines of section 92 of the ASIC Act, and we believe that this would enhance our information sharing capabilities. I am aware that we have been running on perhaps a little longer than you expected.

Senator COONEY—No, I am just looking at your great submission. In no way take that as a hint that I am not interested.

Ms C. Jones—No, I was not referring to that. Now I would like to talk briefly about the importance of getting product definitions right in the legislation and about the critical importance of a smooth implementation of the new regime. Firstly, in relation to product definition, whether a financial product is categorised as a security or another type of financial product—for example, a derivative—will impact, of course, on the regulatory regime which applies to it. Of interest here is the type of disclosure which will be required in consistency for functionally equivalent products.

An example will illustrate the impact which an inappropriate product definition may have. The bill requires a product disclosure statement to be given to retail clients for financial products which are not securities, for which a prospectus is generally required. The bill requires that the product disclosure statement be given in respect of initial offerings and that, where a recommendation or advice is made or given, a PDS is also to be given for secondary sales. Under the proposed definitions, some of our products in the warrants market would be treated as securities and some as derivatives. This would create an impractical outcome for the operation of the market, including additional cost to the issuers and a longer time to market the new products. It would also create confusion for investors to have products traded on the same market and called the same sort of thing being subject to different disclosure regimes. In ASX's view, all warrant products should be categorised as derivatives and subject to disclosure regime for derivative products.

Another relevant factor for deciding the appropriate disclosure regime is whether the product is traded on a public market and the features of that market, in particular the public information features of that market. Under the FSR bill, secondary trades and quoted securities will continue to be carved out from any additional disclosure prior to a secondary transaction, and that is

because of the level of information and advice which is generally available for quoted securities. Secondary sales of quoted derivatives—and possibly other quoted products under the bill—do not currently receive this carve-out. ASX believes that market transactions in quoted products should receive the same treatment where relevant information is available. In relation to disclosure generally, ASX supports disclosure. It is particularly important for the retail clients, but we are also conscious that the production and dissemination of information is costly and that that cost is ultimately borne by the investor.

The last matter we wish to mention today is the critical importance of the transition to the new regime. The FSR bill is the result of a massive undertaking by government in industry. Many details are still to come and will be set out in regulations and in the transitional and other provisions of the bill. A smooth and cost effective transition will be achieved only if there is consultation with industry on the remaining detail and there is sufficient time for industry to prepare. Particular areas where further consultation will be necessary are transitional arrangements and grandfathering, the NGF regulations, regulations generally, the misconduct and enforcement provisions which are currently being drafted and the client order precedence exceptions which are currently being drafted. It is equally important that a realistic and facilitative approach is adopted for transitional arrangement. ASIC's role during this phase will be critical, perhaps even more important than it was during the transitional phase of the managed investments matter. So during that phase and perhaps beyond it wide powers to modify in relation to the law, exempt from the law or extend time in which to comply with the law would be very useful, and ASX would support such provisions.

One area of particular importance for existing market operators will be how the licensing provisions will work. The commentary says that existing markets will be grandfathered for their existing product range. We would like to see a regime which does not narrowly define products for the purpose of licensing. Adopting a narrow approach would lead to some of the very difficulties which the FSR bill is attempting to resolve. It would be counterproductive, for example, if ASX were licensed in relation to particular securities as defined but needed to obtain another licence or another endorsement to a licence in order to quote and trade a product with substantially similar characteristics. It should be sufficient that any rules necessary to accommodate that new product are subject to lodgment with the commission and review and possible disallowance of the minister. ASX looks forward to continuing to work with government on these critical matters. Thank you again for the opportunity to talk with the committee.

CHAIRMAN—Thanks, Ms Jones. Do you have anything to add, Mr Shaw?

Mr Shaw—No, thank you, Mr Chairman.

CHAIRMAN—Thank you for that very comprehensive introduction to your written submission. I assume you had considerable consultation with Treasury prior to the drafting of the draft bill and subsequent to the publication of the draft.

Ms C. Jones—There has not been a great deal of consultation in recent times subsequent to lodging our submission with them. We had felt that the timetable for implementation left them with very little opportunity for further consultation, but it may be that there is now greater opportunity in that regard.

CHAIRMAN—You have raised some fairly comprehensive, detailed issues. What response, if any, have you had from Treasury on those?

Ms C. Jones—We had discussions on a couple of points, which are now resolved. We have not had any further discussions on these particular matters subsequent to lodging the submission.

CHAIRMAN—So you are in the dark as to whether they have been—

Ms C. Jones—The extent to which they may or may not have been taken up at this stage.

CHAIRMAN—In the final bill when it is drafted?

Ms C. Jones—Yes.

CHAIRMAN—Can you give me a bit more detail on why you believe warrants and other hybrid products—instalment warrants and so on—should be regarded as financial products rather than securities?

Ms C. Jones—Warrants are unusual products; they exhibit features of both securities and derivatives. In technical terms, they are currently an option product. The difference between a warrant and an exchange traded option is essentially that they are generally longer dated options than our current ETOs and that they are issued by a third party. So, to some extent, they have in common with securities that there is a third party that issues these securities, but they are not the actual company. They are not products of the issuer, so Macquarie Bank, for example, might issue a warrant product over BHP. Warrants are more generally a product to manage a risk or exposure to another product. They derive their value and importance from that, rather than being an actual asset like a share. In that respect, they fall much more closely into the derivatives camp than into the securities camp. The issuer of a warrant is not in the same position as the issuer of a share to provide relevant market information, for example.

CHAIRMAN—One of the main issues that have been raised with us in relation to product disclosure is the issue of the banks and general information and the impact that product disclosure will have on their counter staff, if I can broadly describe them as such. I suppose it is not directly relevant to your own situation, but have you given any consideration to that issue? Do you have a view on it?

Ms C. Jones—No. I would have to say that we have not given any specific consideration to that issue.

Mr Shaw—We are aware of the concerns that some banks have raised.

Senator COONEY—With the five per cent shareholder limit on ASX, somebody yesterday—I cannot remember who—said that it has got to the point now where ASX cannot really be the regulator in the way it was before, as a voluntary regulator almost. If you went to 15 per cent, wouldn't that make the situation even worse? Have you got any thoughts about that? In other words, if you are going to have self-regulation, let it be done by another body to

be set up. I think that was the proposition put yesterday, although I have not checked the *Hansard*.

Ms C. Jones—I will defer to Alan on this point and the supervision point. As a general comment, the proposal to go to a broader level of individual ownership than the five per cent is subject to the qualification of being appropriate and fit and meeting proper criteria. On the general question of the self-regulatory role in a demutualised entity, I will pass to Alan.

Senator COONEY—Before Alan does that, can I just digress a bit further. This is a theme that has been coming through during our inquiries, that there ought to be great weight given to self-regulation. Telstra was saying that. The great issue is: who is going to carry that out? Yesterday we heard evidence from the Investments and Financial Services Association, the Credit Union Services Corporation, the National Insurance Brokers Association, the Association of Superannuation Funds and so on. Has the time come to get some sort of other association going that might look at all this and provide that basis for self-regulation? I see the next witnesses are from the Finance Sector Union of Australia. They might volunteer to self-regulate the financial sector, but we will have to ask them about that. ASX was more like the people I have mentioned, an association of those who go into this profession, but now it is a company. So it was in that context I was asking.

Mr Shaw—We would, perhaps not unnaturally, support the proposition that people have been putting to you that self-regulation ought to be given great weight and ought to be relied on under this model. It has a number of advantages. I am not sure whether they have been articulated to you, but there are advantages and disadvantages in terms of jurisdiction, of course. The reach of a contractual arrangement can go beyond the potential reach of legislation, especially in terms of cross-border issues. There is also a level of expertise that can be drawn on. There is a general acceptance, when it is self-regulation, of the level of regulation that makes enforcement and application of it easier. It is often more flexible than legislation can be and there is a closeness to whatever it is that is being regulated that helps not only that flexibility and acceptance but also getting the right level of regulation applied in the right quarter. We would say, in our particular case, that we have a closeness to the market and an expertise in market matters that enable us to self-regulate the securities market perhaps better than other people would be in a position to do. We would support the proposition that self-regulation is the right way for the Australian model to go.

In terms of whether that is affected by the five per cent shareholder limit in one sense depends on who might buy shares in the Stock Exchange. If it is not someone that the Stock Exchange regulates, then there is simply no impact in terms of the self-regulatory model because of that ownership in ASX. If it is someone that ASX regulates, that position is not in one sense different from the position which obtains today because there is a five per cent limit. A listed company, for example, or someone else, could own up to five per cent of ASX and we are still the regulator on market of that entity.

ASX has a whole raft of provisions in place to deal with conflict. It is important to bear in mind that conflict and self-regulation is not a new issue that has cropped up because ASX is demutualised. There was always inherent conflict in self-regulation that you apply various measures to deal with. Those sorts of measures include publicity and exposure so that people can see whether decisions are affected by conflict and Chinese wall arrangements and in some

cases eliminating the conflict. For example, on our demutualisation, parliament thought that self-regulation of ASX by ASX was something that should be eliminated. The Securities Commission was given the responsibility of being our supervisor. We have very many different mechanisms—soft, hard and cultural—within ASX that regulate different aspects of conflict. The shift from five per cent to 15 per cent would not necessarily have any impact on that whole self-regulation question.

Senator COONEY—You say that the five to 15 per cent does not change the problems that were there before; it does not add to them or detract from them, it is a neutral issue?

Mr Shaw—Yes.

Senator COONEY—The issue of self regulation has been driven hard. Have people in the industry thought of having a situation where people, no matter where they come from in the industry, can get to a place where they can regulate things, where they can self-regulate, or do you say, 'No, let's stick with the ASX option'?

Mr Shaw—I am not sure I follow the question.

Senator COONEY—We were talking about the union before. They elect their secretaries and their organisers, so that there is a legitimacy to what they do. They are there because they are elected by those whom they are going to service or advise. With the financial sector and the regulations we are talking about, and the self regulation, a lot of that comes through ASX, which seems to have a prominent role. Is that an appropriate thing, given that other sectors of the industry are going to be affected.

Mr Shaw—ASX has a number of mechanisms in place to address the interests of various groups. We have quite a big range of committees that are involved in various processes within ASX. For example, in the listings area, while it is ASX management that would make a decision about the application of the listing rule, there is a committee of external people which includes brokers, listed company representatives and so on to whom an appeal can be taken. That body does not include management representatives. When we are developing business rule propositions, a business rule committee, that includes external people. Of course the ASX board, as a demutualised entity, no longer has restrictions about a person being a stockbroker in order to be a director. Directors are appointed in the same course of events as any other commercial operation, so if people have a particular interest in appointing someone to the board then they could through the AGM process.

Also, with our rules we routinely go to public exposure and invite comments on the rules, which are then required to be lodged with the Securities Commission, and the minister has the final ability to disallow any rule. So there are a number of processes at which people can influence the structure of the regulation that ASX imposes on the securities market. At the end of the day, it is a consensual process in the sense that a company need not list if it does not want to comply with the listing rules or become a participating organisation in ASX. That argument is gaining some currency now because there are other markets starting up, so choice is coming into the Australian securities market area.

Senator COONEY—On another issue, you have expressed some concern about the definitions or the way the bill is presently drafted, and that seems to be a recurring theme. I might say on the record that Hilary Penfold, who is in charge of parliamentary drafting, is absolutely brilliant—in case she reads this. Have your lawyers looked at this?

Ms C. Jones—Yes.

Senator COONEY—Other people have said that their lawyers have looked at it. To your knowledge, has there been any exchange of views amongst the people who have made submissions to the committee?

Ms C. Jones—No. The ASX had some discussions, for example, with the Securities and Derivatives Industry Association, which is a fledgling association for the securities market.

Mr Shaw—And we have had some discussions with the Sydney Futures Exchange.

Ms C. Jones—But not with that broader base who would have made submissions to you.

Senator COONEY—You will get the *Hansard* transcript and you will just see this theme going through. I thought it might be efficient and proper to have an exchange of views. People have drafted suggested amendments and if you had a common drafting program that would be good.

Ms C. Jones—Yes.

Mr Shaw—Senator, I think that would be a good idea. One of the difficulties that we felt, rightly or wrongly—it is not a criticism—was the insufficient time allowed for making submissions in the first place. From exposure of the consultation document until 12 May, I think it was, when submissions were lodged, was in effect about six weeks, one of which was Easter. Just getting our own thoughts in order to make a submission was very time consuming. We really have not felt that we had sufficient time or the opportunity to get other people together to discuss it. As I understand it, the process has been pushed back a bit and that opportunity does present. We may well take it up.

Senator COONEY—That is a recurring theme. People say, 'Look, if you are going to start on 1 January, there are all sorts of problems.' It is not that people object to the general thrust of the legislation but, as somebody said, 'the devil is in the detail'—that is an original statement. It is a great phrase because it does tell you the problems. I thought that might be an interesting way of going.

Ms C. Jones—Yes, thank you.

Senator COONEY—So we will make the transcript available?

CHAIRMAN—Yes.

Senator COONEY—And perhaps even underline the bits where people have said this. Is that too much trouble, David.

CHAIRMAN—You expressed concern about the minister's power to delegate under the bill, but you do not go into any detail about where you think it is inappropriate. Could you perhaps enlarge on that?

Ms C. Jones—As we mentioned, the co-regulatory framework that we have been existing under for a couple of decades now involves that interplay between the government agency, the commission and the self regulator. The delegation power under the proposed bill allows the minister to delegate essentially all or any of his or her powers to ASIC or to a staff member of ASIC. That would seem to run counterproductive to the whole co-regulatory thrust. If, in fact, the minister can delegate to ASIC, then, in effect, the commission is being substituted for that involvement of government. While we are supportive of ASIC and the role that it plays—we mentioned today that we support its power, for example, to audit our supervisory function and its modification and exemption powers—we think that final step really does undermine the co-regulatory model and the benefits that we get from that model.

CHAIRMAN—So what limits would you put on that delegation?

Ms C. Jones—One of the areas that we see as being very important is the rule disallowance power that the minister currently has. If that were to be delegated, for example, to ASIC, I think what you would find is that ASIC would be essentially substituting its judgment of what it felt was the right regulation for the market for ASX's judgment. We feel that ASX is in a better position to get the kind of flexibility to promote business and protect the integrity of the market.

CHAIRMAN—Right.

Senator COONEY—Section 1041D is a very wide delegation and he can delegate to ASIC—

Ms C. Jones—Yes, it is the very last section.

Senator COONEY—or to a member of ASIC or to any staff member. I am just wondering what they mean by a staff member—somebody who started yesterday could be a staff member.

Ms C. Jones—That is right. I am sure that we would not see extreme examples of the exercise of the power, but it would seem prudent to put some restrictions on that delegation power.

Senator COONEY—Are you saying that if it is to the minister it is on the same level as it is now where you discuss with legislators what you think? We would bring a particular approach and the minister would bring the government approach but, once you get to ASIC, ASIC is going to be quite properly influenced by the culture, which is one of the regulations, as well as of facilitating, and where you say 'This is what we say and bad luck for you.'

Ms C. Jones—Yes. That broader government and economic view is important in this area of regulation.

Senator COONEY—It is a section that is often used in an act to say a minister can do something and one thinks, 'This is great—I am going to be able to ring up the minister at any time and go and see him in his office.' But then the whole thrust of that is neutered by saying, 'We really do not mean the minister; we mean somebody somewhere else.' It is like saying you could talk to the minister of police but then saying, 'We don't quite mean that. We mean the senior constable down at the station next door.' So there is a different issue here or a different flavour to all of this.

CHAIRMAN—I have no further questions on these specific details. However, in the weekend press there was a report of comments by Mr Stan Wallis with regard to what he saw was an overemphasis on corporate governance, as distinct from wealth creation for shareholders, through the nineties. What was the ASX's reaction to those comments? If I can lead on from that, do you think that the CLERP legislation thus far in this bill in particular is fitting into the need for encouraging entrepreneurship and wealth creation, or is it more consistent with what he perceives as this overemphasis on corporate governance?

Ms C. Jones—To take the second point first, I think ASX's position would be that this bill comes down far more strongly on the regulatory and retail investor protection elements than on the wealth creation and innovation business development ones. As we mentioned in our statement, there are a number of areas where we feel that regulation has been quite significantly increased without particularly cogent reasons for that additional regulation being put forward. Levels of regulation add levels of cost, levels of inefficiency and can put us at a disadvantage internationally and domestically particularly if there is an uneven application of those levels of regulation. On the first point about corporate governance law creation, I did not see that in the paper on the weekend.

Mr Shaw—Nor did I, unfortunately, so we are at a slight disadvantage in being able to respond it.

Senator COONEY—Don't you get the papers and then have your cup of tea on a Saturday morning?

Mr Shaw—I have two very young children, no.

Senator COONEY—Fair enough.

CHAIRMAN—It was in the weekend *Financial Review* in a report on an address that Stan Wallis gave somewhere. I cannot recall the venue.

Ms C. Jones—It seems to be a similar sort of issue to the second one, that there is an emphasis on the process and protective measures.

CHAIRMAN—I think he was talking about the fact that boards have become risk averse and that there was too much emphasis being placed on having external directors rather than executive directors on boards. As there are no further questions, thank you very much for your appearance before the committee, for your submission and for your answers to our questions.

Ms C. Jones—Thank you very much.

Mr Shaw—Thank you.

[12.20 p.m.]

JONES, Ms Meredith, Research Officer, Finance Sector Union

KING, Ms Emma, National Industrial Officer, Finance Sector Union

CHAIRMAN—I welcome representatives of the Finance Sector Union. We have before us your submission, which we have numbered six. Do you wish to make an opening statement in relation to your submission?

Ms King—Yes.

CHAIRMAN—Please proceed. At the conclusion of your statement we will follow with whatever questions we may have.

Ms M. Jones—Thank you for the opportunity to appear and present our members' perspective on the Financial Services Reform Bill. We represent the interests of about 85,000 members throughout the finance sector, largely concentrated in banks, insurance companies, credit union and building societies. You would be aware from our submission that we broadly support the reforms, subject to the concerns that we wish to raise. You would also be aware that our consideration of the impact of the bill on the sector is quite narrowly focused on the impact that it may have on the working lives of our members in particular. So we are looking only at the training implications of CLERP 6.

To set our concerns in context and to provide background for the committee we offer the following information about the state of the finance sector workforce. It is a workforce that has been through a lot in a lot of ways. It has been at the forefront of change driven by globalisation, technological change, deregulation changes, regulatory reform and almost constant restructuring within individual companies. It is a sector with growing levels of education, but there are significant levels of variation between different parts of the sector. Overall for the sector, 52 per cent, or just over half, of employees have no post-secondary qualification. Our analysis of the 1996 census data showed that within the newer growing area, which is called by the ABS, services to finance and insurance, there tends to be higher levels of education, higher proportion of employees in higher level occupations and better pay. In the more traditional parts of the sector, where our membership is concentrated—banks, building societies, credit unions, insurance—there are lower levels of qualification and greater proportions in customer service, clerical and sales positions.

It is common knowledge that job loss has been a big issue for the workforce. Approximately 36,000 jobs were lost during the 1990s in the four major banks alone. ABS data shows 23,000 retrenchments between 1994 and 1997 for the sector as a whole. Within this trend there is anecdotal and statistical evidence of higher levels of retrenchment for older workers and those without qualifications. There is also a tendency that we have seen for employers to bring in new people with the skills they require rather than concentrating on reskilling and retraining existing employees. It is an industry with very high rates of intra-industry mobility. Over the last four years about 75 per cent of people who leave one job in the industry take up a new job within the same industry, which makes training and portability of skills very important and could diminish a significant cost to the industry. Finally, there is stress and overwork. Overtime is a significant

issue for our members. In 1998 we did some research based on ABS statistics which showed that nearly a million hours of overtime were worked each week. On the whole, the workforce is overworked, stressed and relatively insecure about their positions, particularly in the lower level positions. We believe that the committee should take note of this, as it may have a significant impact on the successful implementation of the reforms, because an insecure workforce is not as receptive to change as a secure one may be.

This leads to our first substantive concern, which is that the change in training requirements may be used as a pretext for retrenching workers who do not immediately meet the standards. Particular parts of the workforce may be more vulnerable than others. The members who have raised this concern with us have tended to be older workers with no formal qualifications who have been through and survived wave after wave of downsizing and who feel that maybe this will be the issue that they get forced out on. I have already referred to the pattern of bringing in new skill rather than retraining existing workers.

Ms King—To illustrate this, financial planners and managers of investment and lending within one of the major banks have already contacted us, stating that they have been told—and they have already completed a qualification—that they must complete a diploma in order to meet the CLERP 6 standards that will be introduced. A number of these members are close to retirement age and believe that the diploma that they have been instructed to complete—in that some of them have just been approached—will actually take longer to complete than the number of years that they will be remaining within the work force. Their understanding is that if they do not commence a diploma, they will no longer be able to hold their position of employment and that that threat has been made. They are also concerned about having to undertake studies at a diploma level, without adequate support from their employer, when a number of them have never completed formal qualifications to this level or have experienced a gap of numerous years since completing earlier university qualifications.

Ms M. Jones—We would urge the committee to consider this potential and to look at options for protecting employees against this potential adverse effect. Our second point relates to our concern that the cost of training not be transferred to employees. We are concerned that this potential exists in a number of ways, primarily through employers not meeting the financial costs or not providing the training required in work time. Because of the nature of work in the industry—particularly in the retail parts of the sector where there are already significant amounts of overtime—people are pressed to do their job, let alone take time out for training, and there have often been calls for training where the demand has not been able to be met because of understaffing and overwork.

In another context, we recently conducted some research—for family-friendly provisions in our enterprise agreements—which showed that one of the main inhibitors of implementation was this pattern of overwork. We are concerned that this pre-existing condition in the industry may inhibit the introduction of these reforms as well and that this may be exacerbated by the relatively short time frame for implementation.

Ms King—Again, just to illustrate this, some managers at a major bank have recently completed a diploma where they were required to complete a three-day course for a diploma that is normally undertaken over 17 weeks on a part-time basis. They were instructed by their employer when and where they must attend, and there was no alternative location or

correspondence course material offered for people who were in country areas or geographically isolated. There was no allowance made at all for family responsibilities, and excessive work was completed by these employees in their own time. As the course was undertaken over such a short time period, employees were compelled to complete a great amount of the work required in their own time, including detailed assignment work.

Anecdotal evidence provided to the Finance Sector Union by this group of employees demonstrates that, in order to meet workplace requirements, staff had to work unpaid overtime on a daily basis and certainly over their weekends. In addition, there was no compensation made to these staff members in relation to their sales targets—and that is a particularly prominent area in the bank at the moment, so staff feel very pressured to meet their sales targets—and as these employees have to rely on the relationship they have with their clients in order to meet sales targets, they had to maintain these relationships while simultaneously continuing to study.

Ms M. Jones—The third point we would like to make is that we believe it is essential that an information and education program is built into the reforms. We are particularly concerned that employees should not have to rely solely on their employers for information about what is required under the changes. That is particularly so because in many cases there has been a breakdown in trust and employees cannot necessarily rely on their employers to act in their best interests. We ask that sufficient resources be allocated to ASIC to develop the information and to target that information to all who are affected by the changes.

The example that we talked about earlier, where the financial planners were told they had to complete a diploma, illustrated the problems. They were told that because of CLERP 6 they had to do a diploma and they were given no more information than that. To question that, they had to go on their own little hunt–they contacted us, we contacted the ASIC. We looked at the interim policy and saw that they recommended a diploma level, but if you speak to them they say that is just a guideline and maybe one subject would be enough. It is a significant process to get that information. We believe that it would smooth the implementation if the information were already there for people, and there would be less anxiety about the changes. People would be clearer about what is actually required and what is just new company policy, and we think that is really important.

Ms King—As an example, the staff within the retail network of major banks now, overall, have a much greater sales focus, and I think this may have been referred to earlier. Previously the focus was much more on customer service. For example, in one major bank the staff had previously been required to refer potential sales on to other bank staff. However, these staff are now expected to sell products and refer some potential sales on to other staff. But providing the referrals requires considerable knowledge by employees of the sales product. There is certainly confusion amongst staff, who know that they must meet these sales targets to continue their employment with the bank and to avoid being placed on performance counselling, and staff are very confused about whether they are going to need training and, if so, to what tier. There is certainly a great level of conflicting information that is confusing employees.

The union also continually receives complaints from members in the retail network about major banks stating that they are not allowed time to attend training sessions in order to further their skill level. Staff feel under a great deal of pressure to meet customer needs within the retail network, due to a great level of understaffing. Many work excessive unpaid overtime and

believe that there is no allowance made by the bank for staff to attend training without penalising the remaining staff by creating further understaffing, as there is no general provision of relief staff. In addition, a large number of staff within the retail network work in a part-time capacity, many as a result of family responsibilities, and allowance in terms of when training is scheduled would need to be made by the bank.

Ms M. Jones—The fourth and final point we would like to raise today is again about resourcing. If the full benefits of the reforms, particularly in relation to training, are going to be achieved, the resources need to be there. There needs to be monitoring to make sure that all the training programs which are available and deemed to be compliant actually do comply and that licensees are carrying out their obligations. I suppose part of this concern comes from an impression that we are getting in relation to the training that there is only one person at the ASIC. Whenever members or I have had queries and have followed them up, we all seem to be getting to the same person, and we are a bit concerned that one person cannot continue to carry the information needs and the monitoring. It may be that there are a whole lot of other staff there and we just happen to get the same person, but it has been a bit of a concern.

The FSU has argued for quite some time for greater investment in training within the industry, and we welcome the new requirements that are contained in CLERP 6. We would not like to see it undermined by a lack of resourcing in the implementation.

CHAIRMAN—Thanks very much for your presentation. You have raised from a different perspective an issue that has been raised with us by a number of the organisations—particularly the banks, building societies and so on—in relation to what they see as a problem with the definitions in the legislation. You are coming at it from a different perspective, but it is in the context of the drafting of the legislation in terms of what constitutes financial advice, what constitutes a financial product and, in relation to the banks in particular, what range of staff are going to be caught up in a requirement to be trained up to the equivalent of ASIC's policy statement 146.

Do you share the concern of the banks that people who otherwise would not be regarded as giving financial advice, such as counter staff, bank tellers and so on, are going to be caught up by the legislation and require additional training?

Ms M. Jones—Our reading of the definition was that, yes, if they were providing information with the intention of influencing then they would be caught up in that. We would like these people to receive training. This is a new role for a lot of them and any training would be a good thing, but it is also a particularly difficult part of the sector to provide with training because of pressures of overwork anyway. So we would support these people probably receiving the training.

CHAIRMAN—So your preference is to have them all trained up to that standard rather than to have the definitions clarified?

Ms M. Jones—Yes.

Ms King—But also simultaneously having differences clarified, because at the moment there is such a level of confusion where people are not sure. People look at what they understand to

be the legislation and think, 'What does this mean for me? I know what I do in my job.' And people's roles have changed fairly dramatically over recent years: where they were previously very much customer service focused, now the pressure is on people to sell. While this change in role has occurred, training certainly has not occurred simultaneously in order to prepare people for the roles. So we would see training as a very useful thing. At the moment a number of the complaints that the union receives are that 'I actually want to attend training but I can't because (a) my employer won't let me or (b) the pressure that it is going to put on other staff means that I can't attend.' So I guess it would depend on the level of training required. That is where the clearer definitions would be useful as well.

CHAIRMAN—We have been given evidence that this could be detrimental to the capacity of financial institutions to maintain their range of services, particularly in rural and regional areas. This was particularly raised by building societies and credit unions who in a number of instances actually operate through agencies: pharmacies, newsagents or whatever. Let alone having the newsagent himself trained up to the standard, the problem of having his staff trained to this standard was one that they saw as virtually insurmountable, and therefore the agencies would, in effect, disappear and the services would disappear. Do you have a comment on that?

Ms M. Jones—We have been very concerned about the removal of services from rural and regional areas as well and would have concerns if one of the impacts was the continuance of that.

Ms King—This is where it comes down to the provision of the actual training as well, in terms of how it is provided and the time line by which people would need to complete the training. So, for example, if someone were in an area that was geographically isolated, would they have an opportunity to complete the course by correspondence work with appropriate support given by the overriding institution, be it a credit union or whomever else, or would they have an opportunity over a longer period of time to actually be able to complete it through travelling but have those costs compensated by their employer? So we go back to the issues that we initially raised in that we certainly have concerns about the impact of bank closures et cetera on rural areas that have occurred to date but that we also do not think that should penalise people in rural areas by their not receiving the training that they should be receiving. It is about this: how is that training to be provided and in what forum?

CHAIRMAN—As they are described to us, these are people who are basically just taking deposits. To the extent that they are giving advice, it might be just saying, 'This deposit gives you interest rate X; this deposit gives you interest rate Y.' Do you think they need to comply with the standards required of someone who is giving financial advice in that instance or could they be excluded from it?

Ms M. Jones—Our understanding of the definition is that if you are giving advice about one or two deposit accounts then technically that is tier two. The standard would obviously be lesser than for someone who is going through a complex analysis of somebody's entire financial situation. Given that it seems that what has been set out in PS146 is a general guideline only, it may be that only a very small amount of training would be sufficient to equip someone with the information required to advise someone else about one or two deposit accounts. That may not be such a significant undertaking, and that may be training which they should be providing to their employees anyway regardless of the changes. One of the things that our members have

raised is that the amount of products is just increasing all the time and that they do not necessarily get the time to come to terms with them. That is to the detriment of the service they are able to provide and, ultimately, the reputation of the companies they are working for.

Ms King—Further to that, while it is true that a number of people who work in pharmacies, newsagents, et cetera, are taking deposits only, there is certainly an expectation for at least a large number of those employees to sell financial products or to at least make people aware that there are other financial products available. It is perhaps not as simplistic in all cases as it may have been presented, I would suggest.

CHAIRMAN—I note your submission says that a major deficiency with the existing requirements for ensuring a representative was competent was the lack of any objective benchmark. Policy statement 146 has been in existence for some time now. Am I to conclude from your statement that you regard PS146 as an insufficient benchmark?

Ms M. Jones—No. Our understanding was that previous to that—this is not my area of expertise: this came from our training representative—one of the issues had been that for different parts of the sector there were different standards required, but that PS146 was actually a good step along the process to developing objective benchmarks. It was not a criticism of PS146 at all.

CHAIRMAN—Have you made any assessment of the cost to the industry of the training requirements that might be put in place?

Ms King—It is also difficult to make an assessment when we are not quite sure what the training requirements will be. For example, for someone working as a teller in the retail network we have a differing view about what the training requirements might be. As my colleague mentioned before, some of the training requirements may not necessarily be that great, so it is difficult to fully assess it. It is our understanding that someone working as a financial planner will undergo training on a fairly regular basis because they require that in order to fulfil their role. It is a matter of being able to establish what sort of training would be required for people with different roles within financial institutions. I hope that clarifies it for you.

CHAIRMAN—You also expressed concern about the possibility of older workers with no formal qualifications becoming redundant under the legislation. Are you seeking some sort of grandfathering provision for workers who may have no formal qualifications but they have a lot of experience and have therefore developed a relevant level of competence through that?

Ms M. Jones—Our understanding is that—and this is one of our concerns too—the information that people have been given by their employers is not actually what is required, say, under 146. Within 146 already there are provisions for people to undertake a recognition of current competency—that if there are any gaps in that they may only have to undertake gap training as opposed to fulfilling this, if they were starting in the industry afresh. Provision has been made for that. Our concern is that that information is not readily available to the people affected and this is having a significant impact on their sense of security about their work.

Senator COONEY—I was looking at the submission from the Australian Bankers Association. They will be here this afternoon. They have made a submission and they have touched on

the point of representatives in the country. They say that there are all sorts of problems with that, including the fact that the representatives might move on. Is it your understanding that those representatives in the country do give advice about products that the bank may have available? Do you know whether they are obliged to do that?

Ms King—I think it is inconsistently applied, depending on the institution which the person would be working for. There is no doubt that overall, particularly within the banks, there is an incredible sales focus. Looking at the performance requirements of individuals, the key performance indicators rest largely on their sales figures and all referral figures, if you are working in some sort of branch network in either a country area or a city area. I would imagine that different banks have different expectations of their employees as to what degree that will occur.

Senator COONEY—But it is not a situation where a customer goes in and either puts in a deposit or withdraws some money and the teller or the person in the country simply goes through the mechanical task of handing over the money?

Ms King—From personal experience living in a country town, I do not think I have ever walked into a bank and not been asked if I would like to increase my Visa limit or something to that effect, so I think that there is genuinely much a pressure on individuals to continue to refer.

Senator COONEY—From your membership, it is quite clear that there is an obligation almost; well, not almost: there is an obligation to try to sell.

Ms King—Overwhelmingly we hear from our members about the pressure. Some people, particularly individuals who have worked, for example, for banks for a long period of time, have found the change very difficult, because they have gone from a situation where they are used to providing really good service to customers, and particularly in country areas where they form very strong relationships with their customer base, and it seems a bit of a centre, one where people can rely on them. Now the pressure is out to sell and often not to go into the branch network simultaneously in order to reduce their own jobs, so they are feeling very much under pressure to sell products or to reach that referral level, whereby they can refer people off so that products can be sold to individuals.

Senator COONEY—As far as you can gather, there seems to be no education given by the bank to the people in the country to sell?

Ms King—No, other than perhaps from time to time how to sell more and how to sell better.

Senator COONEY—What about the people in the city where you have got regular branches: what sort of training do they get? Do you know?

Ms King—It is very spasmodic, I think it would be fair to say, particularly when you are looking at the retail network. For example, ANZ—I hope this is correct—have actually closed their training centre in Western Australia, which tends to give a bit of an indication about the value that is placed on training. I do not know whether they are giving training to individuals in some other forum, but we continually receive concerns from our members in retail networks about, 'Well, either training is not provided, or if I go the pressure that I am putting on my

colleagues will mean that there will be queues out the door that day and customer anxiety will continue to increase, et cetera.' Certainly it would be fair to say that a number of our members are facing continued abuse from customers because they are waiting in such long queues and so on because they are so busy being asked whether they would like to be sold a product, and there are fewer counter staff available in any case. I am not sure that answers your question entirely.

Senator COONEY—Part of the submissions that have been put to us is that there ought to be a continuation and even extension of self-regulation, and that might work if the people that want to self-regulate have a particular culture and a particular ethical approach. But from what you tell us the banks can be quite oppressive of their staff: would that be using too strong a word?

Ms King—No. Certainly particular groups, for example managers of investment and lending, have found that the sales pressures placed on them have increased phenomenally. There is a particular term for it, but it is almost about reaching a group of targets that are almost unobtainable, and you get particular rewards if you fall into that category, so the pressure being placed on people to reach those targets is phenomenal. We have concerns ourselves that on one level people are expected to follow through certain processes when providing advice to people, yet simultaneously the pressure that is placed on individuals to sell as much and as many products as possible has a real conflict in itself, and certainly our members are feeling that conflict and I think are fairly concerned about what it means for them. We have had examples, for example, of people holding their sales targets over to the following month so that they can meet those targets for the next month where they know that it will be slower because there might be a break of Easter or something that will mean that they receive less sales targets within that period of time.

Senator COONEY—Would it be too strong to say that the banks are almost obsessed with getting sales of different products up?

Ms King—In my personal view, no; it would be very true.

Senator COONEY—Are there any ethical standards set out for bank staff to adhere to?

Ms King—I am aware that there are certainly processes in place that staff are expected to follow. I guess particularly when you are completing transactions or when you are giving someone advice, you are expected to follow particular policies and procedures, and if you do not follow those policies and procedures—I guess when people become aware of it is when something goes wrong.

Senator COONEY—Is that put out to make sure that the bank stays within the law, or is it put out to try to establish an ethical basis for conduct in the bank?

Ms King—I guess the bank would need to comment on that.

Senator COONEY—There has been a downsizing, as people say, of the staff, is that right?

Ms King—Yes.

Senator COONEY—Included in those people that have been downsized are people with experience in the way that banking used to be conducted?

Ms King—Yes, very much so.

Senator COONEY—So the people that were brought up in a culture of servicing the customer are being downsized. Would that be fair to say? They are being sent out into the world and away from the bank.

Ms King—It would be fair to say, from experience of the people we see, that they have found it quite traumatic. They were used to working very closely with individuals. They had been involved in wealth creation, feeling like they were genuinely doing the right thing by the customer, spending time with them to help them work out the best portfolio, et cetera, for their interest and taking perhaps more time to reach that conclusion so that the customer had a higher level of comfort. But that service certainly acts in conflict with the pressure to sell and to sell more.

Ms M. Jones—Although this is not so in every case, we have seen a tendency for banks, when they take a new direction—and a new direction may mean needing new skills—to want to bring those skills in from elsewhere rather than look at the staff they already have and say, 'How can we help you to meet the standards?'

Senator COONEY—I suppose bringing the staff in from outside is consistent with trying to change the culture from one where it is customer orientated to one where it is sales orientated. Would that be a reasonable thing to say?

Ms King—Yes.

Senator COONEY—I asked that in terms of self-regulation and in terms of regulation that we might put into place. If the culture is changing, there might be a need for more, rather than less, regulation.

Ms King—As a union, we would have a view on self-regulation. We would have a concern about inconsistency in the application of it, given the large number of financial institutions that exist. While they are each very aware of their own products, it is another issue altogether as to how they would each seek to provide training to their staff, the quality of the actual provision of training, the application of training and also, in particular, protection for employees who might be disadvantaged in some way, as we discussed earlier in our submission.

Senator COONEY—We have been discussing the banks' money; what about other financial institutions? Are they following much the same way as the banks, or are there different approaches depending on the institution?

Ms M. Jones—Most of the concerns that have been raised with us about this specifically have come through the banks. We are still looking beyond the banks to monitor how this is going to be played out.

Senator COONEY—Do you cover credit unions?

Ms King—Yes, we do.

Senator COONEY—And national insurance brokers?

Ms King—We cover insurance companies.

CHAIRMAN—Not brokers?

Ms King—We do have some.

Ms M. Jones—Some, but not a large proportion.

Senator COONEY—And superannuation funds?

Ms King—Yes.

Senator COONEY—What sort of signals are being sent to you by members from those areas?

Ms King—I should firstly state that the majority of our membership is in the area of the banks, which is what we have focused on today. But my understanding is that other institutions would have the same pressures.

Senator COONEY—Don't you cover those other ones with the same enthusiasm?

Ms King—We certainly do. It sometimes takes a bit longer to find them.

Senator COONEY—I will have to start looking at the morals of this!

Ms King—No, not at all, I can assure you. Again, it would probably be very different. Given the size of some of the credit unions and given that the size of them varies quite markedly, we are probably less likely to hear concerns from some of the smaller ones, which tend to be a bit more family oriented. It is quite different.

Senator COONEY—That is where the culture is conducive to service.

Ms King—Yes, that is correct. In some superannuation companies, for example, we know the same sales pressures are there, and we have heard concerns from those members about those same sales pressures. So it would probably be amongst the other institutions. The approach applied would be inconsistent, but there does seem to be a general view that selling is necessary in order to survive, and therefore the pressure is on staff to sell in order to keep their jobs and, they believe, for their institutions to survive and prosper.

Senator COONEY—And the interests of the customer are a lesser concern than they used to be.

Ms King—Yes.

Senator COONEY—That would be consistent, wouldn't it?

Ms King—It would be consistent with what you are seeing, for example, in rural areas where organisations are often being closed because they are not seen to be as financially viable.

CHAIRMAN—As there are no further questions, I thank you very much for your appearance before the committee and the evidence you have given us today.

Proceedings suspended from 12.55 p.m. to 2.00 p.m.

GILBERT, Mr Ian, Director, Australian Bankers' Association

HEALEY, Mr Gary Hugh, Director, Australian Bankers' Association

CHAIRMAN—Welcome. We have before us your submission which we have numbered 20. Do you wish to make an opening statement? If so, you may proceed and then we will move to questions.

Mr Gilbert—Thank you for the opportunity to address the committee. I have a fairly brief opening statement, and I will read it. The Australian Bankers' Association represents 24 authorised banks operating in Australia. Authorised banks operating in Australia have, in Australian dollar value, $665 billion in assets as at May 2000 and, in Australian dollars, $523 billion in liabilities. That is according to Reserve Bank of Australia statistics.

The ABA supports the general objectives of the draft Financial Services Reform Bill 2000 in that they include the licensing of financial services providers; ensuring that consumers get adequate information to make informed choices and understand the financial products they seek to acquire; ensuring that there is transparency and accountability in financial services relationships; ensuring there is flexibility in the regulation to take account of different functional aspects of financial services; and to ensure that consumers have access to cheap, effective and independent dispute resolution mechanisms.

Having supported those objectives in the bill, the ABA is concerned that the proposed regime does not take sufficient account of the functional differences between certain financial products, the prime example being the differences between traditional basic banking products issued by authorised deposit taking institutions, and other products such as investment or market linked financial products such as superannuation and investment life insurance.

In the case of basic banking products such as deposits and transaction accounts, they are issued by authorised deposit taking institutions that are prudentially regulated bodies. These products are capital assured; they are not speculative or linked to the market. They are generally repayable on demand, and they are simple, well understood products out there in the community.

The proposed regime in the bill would seek to overlay a single set of protocols that have been designed around investment products where there is a potential risk of loss, both of income and of capital, thus disregarding the functional characteristics of the simple deposit.

Two key areas in the draft bill where this is apparent are, firstly, in the singular treatment of advice irrespective of the risk profile of a financial product and the community's general knowledge of that product, and, secondly, in the arrangements for alternative distribution of these simple banking products, particularly through third party structures such as agencies and the like.

The financial system inquiry report—the Wallis report—at page 263 recognised the differing functional characteristics of financial products when proposing that regulatory oversight of disclosure requirements should be conferred on a single regulator, which we all know is now the

Australian Securities and Investments Commission. The report said that whilst disclosure on deposit accounts should be part of that regulator's powers:

> ... in certain cases it may not decide to exercise these powers. For example, deposit taking institutions—

Defined as DTIs—

> continue to be subject to less onerous financial disclosure requirements for deposit taking than for other fund raising, given that they are subject to more intensive prudential supervision than other providers of financial services. While DTIs are not required to provide a prospectus for deposit taking, they are subject to product disclosure requirements under various codes of conduct.

I quoted from the report because it is important that the Wallis committee recognised that there was a different level of risk and profile in simple banking products compared to those of an investment nature where a prospectus, for example, might be required. Whilst this recognition of difference has been reflected to a degree in the draft bill in respect to product disclosure, the approach does not flow through the bill's provisions relating to other requirements, particularly advice and third party relationships.

A further aspect of the bill's provisions concerns the requirement that would be necessary when a bank wishes to appoint representatives to act on its behalf. The bill, as currently framed, would require the bank to notify ASIC within two business days of the appointment or cancellation of the appointment of an authorised representative. This would extend not only to, for example, a newsagency or pharmacy proprietor acting in an agency capacity but also to every employee of that business who may be involved in providing financial products to retail clients. We apprehend that the tasks for counter staff in banks and their agencies will become more onerous. Greater costs may be incurred in training and supervising them, and this could lead to a reduction in small business being willing to take on the agency-type activities for banks in both city and rural areas.

Another but related aspect of appointing authorised representatives concerns the nature and function of the bank group of entities itself. Under current proposals in the bill, every employee of a bank who holds a financial services licence would not require separate authorisation to act for the bank in providing financial services, but if an employee acts on behalf of another entity in the bank group—a related company—the employee must be specifically authorised and ASIC informed accordingly. This approach seems to ignore the nature of the financial conglomerate—a phenomenon on which Wallis commented. The typical conglomerate in the case of banks was reported by Wallis to be an ultimate holding company, a licensed bank or, in one case, a life company. If I could, perhaps to save time, refer the committee to page 17 of our submission to this inquiry in which there is a substantial text from Wallis quoted, recognising the phenomenon of the financial conglomerate. The ABA submits that, in recognition of this trend, the bill should provide that employees of related entities in a conglomerate should not have to be separately authorised as representatives of other entities in the conglomerate group of companies.

All that said, I am pleased to advise the committee that we have had recent encouraging discussions with the Treasury on these issues. Of course, the committee's endorsement for the adoption of these approaches throughout the bill's provisions for the treatment of basic banking products and arrangements for their distribution would be of great assistance. Finally, on a

separate matter, there is some constitutional uncertainty about the adequacy of ASIC's powers to effectively act as regulator under this regime. The ABA believes that, for the proposed regime to work effectively and with certainty for both consumers and financial institutions, ASIC's powers should be beyond question. To the extent that a referral of powers by the states is necessary to achieve this level of certainty, the ABA would strongly support that step.

CHAIRMAN—Thanks very much, Mr Gilbert. Notwithstanding that there are particular issues that have been raised by other groups over the last couple of days that need attention in relation to definition of what is a financial product and what is financial advice and those sorts of issues, given the full ambit and detail of your submission, would it be fair to characterise it as saying that, if all of the issues and concerns raised in your submission were met, it would effectively remove banks from the ambit of the legislation?

Mr Gilbert—I do not believe that would be the case. I think that we at this stage are under a very clear message from the government that any question of these deposits or transaction accounts being removed from the regime is a full-on hope. However, we do believe that there is fertile ground on which to explore ways of treating like with like; in other words, treating these products still within the regime with a degree of temperance where, say for investment products, there would need to be a greater intensity.

CHAIRMAN—I was not focusing on that particular issue of the product. I was looking at your submission in the broad, but we can perhaps move on to those more specific issues. One of the particular concerns that has been expressed to us by banks, especially by building societies and credit unions, is where the divide comes between the provision of factual information and the provision of financial advice and what is a financial product—in particular, the impact that may have on rural and regional people and the capacity of financial institutions to provide deposit taking services and those basic over-the-counter services to rural and regional people if the staff have to be trained up to the standard of PS146, as seems to be the case under the draft bill.

Mr Gilbert—Exactly. It is a point that concerns not only the banks but also the other ADIs who have appeared before this committee. To try to draw in legislation the distinction between what constitutes factual information and what constitutes advice is a very difficult thing to do. In a face-to-face conversation between a teller or an agent in a country town and a customer it is very difficult for a person to control the flow of that discussion and, in the middle of that discussion, start to draw legally technical boundaries between factual information and the giving of advice.

If the committee is aware that the definitions in the draft bill create the ability to, or the difficulty in, setting that dividing line, advice constitutes a recommendation, a statement of opinion, an interpretation of information or a report on an interpretation of information. Explaining product features to a customer who has explained what they want out of what is simply a basic banking type product and saying to a customer, 'We have this deposit product with these transactional facilities and we have this deposit product with different transactional facilities. From what you have told us, it would seem that that product is the one that is better suited to you,' that person, under the bill's current provision, has given personal advice. There is nothing that we can see in the bill that directs the regulator to have regard to the degree of proficiency that that person need have in giving that advice. What we are concerned about is the

fact that there may be some uniform element of training coming into this where, in fact, the training needs to reflect the nature of the product and the type of conversation. The risk profile of the product, which in terms of the example I have just given, is negligible—taking all those factors into account rather than committing the institution or, if it is an agency in a country town, the staff of that agency to a far more rigorous training program.

CHAIRMAN—You indicated in your comments a few minutes ago you were of the view that to get any change in this area was a forlorn hope. Could you perhaps enlarge on that. I understand there have been some recent meetings with Treasury in the last day or two to follow up some of these issues.

Mr Gilbert—Yes, we met yesterday.

CHAIRMAN—Could you perhaps enlighten the committee as to the outcome of some of the discussions.

Mr Gilbert—I would like to correct one impression if I have perhaps created this incorrectly. The forlorn hope we had was actually removing deposit and transaction accounts from the regime altogether. That has effectively, at this stage, been ruled out. We are not so depressed about the prospect of further accommodation of the sorts of views that we have been putting to Treasury and to you today.

CHAIRMAN—The issue of advice.

Mr Gilbert—Yes, the issue of advice. As a result of yesterday's meeting, Treasury have been given some things to think about and have gone away to think about them. They are thinking about the nature of the conglomerate and the extent to which authorisations need to be given to employees within that conglomerate, and also the issues in relation to the appointment of third parties and the extent to which authorisations are necessary, particularly when we are talking about the low end of the spectrum in terms of risk profile and lack of community understanding of the product. We would like to think that we can be encouraged by the discussions we had with Treasury yesterday.

CHAIRMAN—Have you made any estimates of the cost of compliance if the measures go through as they are currently drafted?

Mr Gilbert—It is a very difficult thing to do. We have had some recent experience with the Uniform Consumer Credit Code—all credit providers have—in putting a similar type of regime, in terms of dimension, into place. By comparing what banks and other credit providers had to do under the consumer credit code, we examined the typical areas where reform or changes would be necessary, such as training, procedural manuals and computer systems—and a lot of documentation is now computer-driven as an aid to compliance and efficiency—and other documentary changes, such as brochures, marketing material and the like. Without being able to put a precise figure on that, I can simply say that the sorts of estimates that we are currently looking at across the membership would total in excess of $100 million. The cost to get to the line for banks in relation to the consumer credit code was about $100 million, with some recurring costs annually. We estimate—and I do want to put the qualification to the committee

that this is not a hard and fast calculation; it is an estimate—that this regime is roughly of that order.

CHAIRMAN—To what extent do you get customer complaints about the provision of information on low risk products, such as deposit accounts and so on, that would lead to the conclusion that there is a need for increased consumer protection, as seems to be envisaged in the legislation?

Mr Gilbert—We at ABA get very few. The Ombudsman may get a few; I do not know what level of complaints may exist there. Generally, the complaints to the Ombudsman scheme or to banks in general at this lower end of the spectrum are more to do with administrative problems that arise in relation to the account after the account has been established. It might be accounting or it might be getting a name wrong or an address wrong or sending something to the wrong person in the household or something like that. But it is not so much in terms of the set-up and whether the product actually fits the consumers' needs or not. If that were the case and the consumer said, 'I've changed my mind. I don't want that product; it doesn't suit me,' they simply withdraw the money, because it is repayable on demand, and put it into a product that is more appropriate. It would be difficult to see a dispute arising in relation to that type of situation. Conversely, if you were put into a longer term investment product where there were entry and exit fees in relation to it and you did not understand what that product was going to do for you, you would have real cause for complaint. This is where we see one of the essential differences being.

CHAIRMAN—Are you aware of the holding out provision that applies in Canada, whereby bank counter staff or tellers or their equivalent provide a range of information but, if questions from the consumer lead to more complex financial matters, they are referred to an adviser? If you are aware of it, how do you think that option might work in Australia? Could that be incorporated into the CLERP provisions?

Mr Gilbert—It is certainly an idea we have mooted with the Treasury in the development of this regime. It was considered inappropriate.

CHAIRMAN—By Treasury?

Mr Gilbert—Yes.

CHAIRMAN—Does the ABA have a view on it?

Mr Gilbert—We put it as a view in the very early stages of CLERP and have since been looking for alternative ways of trying to accommodate this tension in the definition. The Canadian experience, unfortunately, is not available at this stage because the regime is still being finessed, so we do not have any road testing on it. The concept of the scheme is that anybody who holds themselves out by implication or expressly as capable of giving financial advice has to be licensed and has to be trained. It would be an offence to hold yourself out or imply that you had those qualifications if you did not have them, which would leave everybody else who did not hold themselves out as people who were not advisers. An example in Canada was given. It is a bit like regulating a profession, whether it be lawyers or doctors. You do not actually tell them what it is they have to do or not do. They are trained. They become registered

with their professional body and by dint of that are entitled to practise. It is the movement of the adviser from the position they are now in to a position of quasi-professional which is what Canada is seeking to engender so that there will be this body of professional people who are able to hold themselves out and licensed to do so to provide expert advice. In regard to anybody else who is not part of that, community expectation is that they are not advisers. That certainly is one route through this difficult problem.

CHAIRMAN—You refer to the one size fits all aspect of the legislation. I guess that is a consequence of trying to get a simpler system. In a situation where you have got a range of different types of financial products with different degrees of complexity, do you think it is possible to get a one size fits all regime?

Mr Gilbert—It is certainly possible to get a one size fits all regime. The question is whether the cost of complying at the lower end, the low risk profile product, is warranted in terms of the corresponding consumer benefit compared to that regime as it applies to the more financially sophisticated products. It is certainly possible but it is perhaps not economically practicable.

CHAIRMAN—What is your view on the appropriateness of cooling-off periods?

Mr Gilbert—For general insurance products and the like, there is a specific provision in there in relation to those products. It does not apply in relation to the normal bank products and so forth.

CHAIRMAN—And you do not think it is necessary for broad financial products?

Mr Gilbert—Where the products are available on demand, you are not bound for ever and a day to keep your money in the account. You simply make the demand and it is repaid.

CHAIRMAN—What about other financial investment products that are not insurance related?

Mr Gilbert—I have not turned my mind specifically to that, given that I am representing basically banks and banking products. It is certainly a model that has been followed in a number of areas, including real estate contracts and the like.

CHAIRMAN—Before lunch we had representatives of the Finance Sector Union giving evidence. They expressed concern that the weight of the training requirement under CLERP would be shifted onto staff rather than met by the banks in terms of making time available for them to take up whatever training is required, any costs associated with that and so on. I am just wondering whether the ABA has a position in relation to staff training.

Mr Gilbert—We do not have a position in relation to staff training. That is the first time I have heard that statement made about the intention of banks. It is certainly not an intention that has been communicated to me or even one that I would expect realistically to be pursued by any of our members. What we are saying about training is that training needs to be clearly specific to the tasks that are being undertaken by staff, rather than having a one size fits all type of approach, and that that needs to be clearly set out in the legislation. There has been nothing

suggested to me that that would be a policy of any particular bank and it is certainly not a policy that the ABA has in any way, shape or form considered or even formed a view about.

CHAIRMAN—Are there any further questions? Senator Cooney.

Senator COONEY—So the banks do undertake all the training that is required? Following on from what the chairman said, that was one of the thrusts of the union's position, that there was not training appropriate to what the person who would be having training had to do. You would say that is just not on and that is just not right?

Mr Gilbert—I cannot speak of current training requirements, but under this regime you are going to have to have people trained specifically for the tasks that they are employed to do. If they are involved in giving personal advice about products of a more sophisticated nature than banking products, they are going to have to be trained accordingly. There should be no equivocation about this. If people are looking for financial advice, they need to go to qualified financial advisers. But at this lower end of the spectrum, as I keep saying, there is a different risk profile and a different amount of information that is needed. Basically, tellers should be free to assist customers without being trained to the level of financial advisers.

Senator COONEY—So I take it from what you were saying that they were mistaken in saying that tellers had to tell customers about the products that the bank might want them to become aware of?

Mr Gilbert—I am sorry, I did not understand the question.

Senator COONEY—What they were saying was that with tellers in the old days the idea was to give service to the customer. The emphasis—and it is only an emphasis—is now more on making sales, for the bank to make sales of its products, and that in fact—and this is probably why you do not understand, because from what you say it does not happen—the tellers now tell people who come to them about products that the banks might have. But I gather from what you are saying that that is just not on.

Mr Gilbert—The banks are in the business to ensure that customers are aware of what the product range is, just as any other retailer will carry on his or her business.

Senator COONEY—Perhaps we are talking at cross purposes. The tellers will inform people about the various products that these banks have?

Mr Gilbert—Yes, which is basically factual information about what is currently available or what is even on special.

CHAIRMAN—I think the emphasis that the union representatives were putting was that, as Senator Cooney said, in the so-called old days the whole emphasis was on providing a service to the customer. There is now pressure on all bank staff, including the front counter staff and tellers, to sell products to customers, not just to worry about servicing what the customers might need but to actively market products, even to the extent that the union representatives were implying that there were quotas for the sale of products that had to be reached each month and so on.

Mr Gilbert—Obviously they are the individual business decisions of banks. That is not, as it were, an ABA matter.

Senator COONEY—That presents us with a problem. If you had tellers or some agent in the country—whether it was a pharmacist or newsagent—simply giving a service—say, you went in there and put your deposit in and then took part of that deposit out—that would be one thing. You would then say that they should not have the sorts of regulations that are appearing in this legislation imposed upon them.

But if on the other hand they give advice in the sense of saying, 'We've got these products available and you might want to think about a product that will give you greater interest,' then that slips into another category. Whether it carries over towards becoming advice is another matter. How this legislation is drafted should depend upon exactly what it is that the person who is facing up to the customer is required to do. But you say that is a matter for the individual bank to decide.

Mr Gilbert—In terms of what sorts of incentives or guidance or instruction they give to their tellers in relation to the marketing of products from, say, the group, yes.

CHAIRMAN—In terms of what role the tellers are playing. Are they actively marketing or are they just taking deposits and administering withdrawals and so on?

Mr Gilbert—In my personal experience they are doing both. What the arrangements are or what the incentives and so forth behind that are would vary from institution to institution. I am obviously not aware of all of those.

CHAIRMAN—If they are doing both then it would indicate a need to bring them up to a trained standard.

Mr Gilbert—It is a critical issue as to whether recommendations are being made to people about what is going to suit them in terms of their lifestyle, their financial needs and objectives and so forth. If these people are making recommendations on complex financial products, it is very clear that under this regime they are either going to have to be trained to give those recommendations or they are going to have to refer that customer to a properly trained person to do that task. They can at least inform the customer on what is currently available.

Senator COONEY—I suppose if you have got somebody in the country and that was the only place he or she could go to deposit or withdraw the money he or she has, there was nowhere else to go, that would be of some concern. If what the agent does is give advice, then clearly that advice ought to be appropriate advice and should be of as high a quality as possible. If you go from the agent looking after the bank down to some doctor who has been trained but is now delicensed and people say, 'This is all we can do for you because you are a country town and you can't expect top service, you've got to take what doctors or accountants we give you,' that seems a bit harsh. If you then say, 'There's nothing you can do about whatever mistake is made because that is not advice,' it is a difficulty for the consumer.

Mr Gilbert—If there is no choice in the country town?

Senator COONEY—Yes.

Mr Gilbert—I suppose our concern with this regime is that if there is choice then the level of choice might be reduced if some of these arrangements impact adversely on businesses that are providing those alternative delivery channels in those towns. I will go back to what I was saying earlier. If we are simply talking about a very basic banking type facility—a deposit account, cheque account or some other form of transaction account—the sort of advice that anybody is giving about that type of product requires an understanding of the function or functions of the products and need to be trained appropriately in how the products operate, but certainly not on the economic cycles and so forth of the Australian economy which a financial adviser clearly would require to be trained in.

Senator COONEY—As you say, it varies from bank to bank and it is not clear exactly what any particular agent or teller might do. Wouldn't it be better to leave the definition as it is and leave it up to the courts to decide in any particular example what the situation is? You have to try to get a balance, as has been said, between the ability of the banker or any other institution to do its business and, on the other hand, protecting people from a situation that is unfair, I suppose. To put that into black-letter law in such a way that that becomes absolutely clear is a bit difficult, I think. Do you have any comments about that? If all that the person is doing is giving information then there should be no worries at all. It is only when the person starts to creep beyond that that there is a difficulty.

Mr Gilbert—In a discussion from which, for example, a recommendation might be inferred—which, again, is the type of casual conversation which is very difficult to control midstream.

Senator COONEY—Yes.

Mr Gilbert—It is interesting that, in the definition of financial product advice in the bill, what constitutes personal advice hinges on whether the teller, for example, has taken account of the financial needs and objectives, et cetera, of the customer or, quite extraordinarily, whether the customer could reasonably have assumed that to have occurred. In fact, there is nothing in that definition which suggests that the customer should perhaps be more concerned with the skills qualification of the person behind the counter who is talking to them about these sorts of things.

I suppose I come back a bit to the Canadian position on this: that, really, if someone is giving advice then they cannot give it and cannot hold themselves out to be giving it unless they are qualified to do so. I believe that the definition of 'advice' in the bill, as it is currently drafted, is going to be extremely difficult to manage from a risk management point of view, and it would be unfortunate if the uncertainties in that provision actually created difficulties and differences with customers.

Senator COONEY—You are in good company, may I say. I think the Chairman would agree that this is a complaint that is made again and again. It is a problem. I am going back a long way now, I suppose, but all you used to do was to deposit or withdraw your money and talk about the football and the weather, and that was it. What concerns me now, though, is that the emphasis has changed a bit to where there is—and, as you say, legitimately—an attempt to interest

people in the products that the bank might have, That seems to me to be going beyond the area of purely providing information.

What if I went to the doctor to talk about varicose veins and he said, 'What about your heart? You had better have a heart operation?' If I need a heart operation, that is fair enough, but he has introduced it and I have gone on his advice. In a certain sense he is just providing information by saying 'You have a very bad heart,' but in another sense he is influencing my decision. If we are going to have legislation like this, it seems to be a bit of a concern. How can we find out exactly what these agents and these tellers do? Is there a list?

Mr Gilbert—Presumably they all have job descriptions of some sort or another within their organisations. It really would be a case of asking each of the financial institutions concerned. I am sorry that I do not have that material at my fingertips.

Senator COONEY—Do you have anything to say about the mix of self-regulation and regulation under the legislation? That has been another issue that people have raised.

Mr Gilbert—We have seen a range of self-regulatory initiatives over the last decade, starting with the setting up of the ombudsman scheme in the late eighties, the development of the electronic funds transfer code of conduct in the late eighties and the launch of the code of banking practice in the nineties—all self-regulatory initiatives. We now see all of those arrangements falling fairly and squarely within the ambit of this proposed legislation. Obviously, decisions will need to be made once we know the final outcome of the legislation as to where those arrangements sit, how consistently they sit with what is in the legislation and what changes we may need to make to those arrangements—including whether we need them at all, because the bill proposes extremely comprehensive coverage. We are currently reviewing the code of banking practice, via an independent review process, and we anticipate that we will only get so far with that review and will then have to put that on hold until we see the outcome of this legislation. I think it is an inevitability that whatever self-regulation is out there now will come in and sit underneath a legislative umbrella.

Senator COONEY—There have been some problems with the definitions. Have you had any legal advice about the effect of the definitions in the bill as they are now? I ask that because problems involved with some of the definitions have been drawn to our attention. We were wondering whether the various lawyers who advise the separate people who have given evidence could get together on that. Did you get any advice on that?

Mr Gilbert—Yes. We were assisted significantly in the preparation of our submission by lawyers, and some of the definition issues—those of particular concern to us—are teased out in the early parts of the submission. It is a clear policy objective of the government to exclude non-consumer credit from this regime. However, there are aspects of definitions which seem to not exclude it in some cases. So, yes, there are definitional problems.

Senator COONEY—You would not leave that to the courts to tease out? If you accept the courts as being reasonable institutions that want to be sensible about things, a lot of the problems might be solved by litigation. You would only need one or two cases, I suppose. What sort of response does the Bankers Association have to that?

Mr Gilbert—I would have thought that that was a last resort. It would be far better for one to get the definitions right to reduce the scope for argument and the utilisation of public resources in litigation, although some have clear vested interests in that. Many of these concerns and these disputes are going to have to be fielded within the banks themselves through the internal dispute resolution, and if they cannot sort them out internally the disputes are going to have to go to the ombudsman scheme to be sorted out down there. All I could say is that it would be unfortunate if the courts had to step into the fray in some of this stuff.

Senator COONEY—Can you think of any definition that cannot be disputed and that cannot be taken to court by some litigant?

Mr Gilbert—I think that there is a definition of 'person' in there. Many of the definitions are complex—what 'facility' means and what 'making a non-cash payment' means. Those sorts of definitions are difficult as to what falls inside and what falls outside of them. It is important in legislation such as this, where an organisation such as a bank is seeking to comply, that the organisation is clear about what its obligations are and what is in and what is out so that the industry as a whole can spend its $100 million or so on getting to the line and, hopefully, not having a court upset all that on the basis of a flawed definition. We would hope that that could be avoided.

CHAIRMAN—Thank you very much for your answers to our questions following on from your presentation of evidence. It was most useful.

[2.47 p.m.]

CAMPBELL, Mr Malcolm Barling, General Counsel, Bendigo Bank Group

JOHANSON, Mr Robert Niven, Deputy Chairman, Bendigo Bank Group

OATAWAY, Mr David, Company Secretary, Bendigo Bank Group

CHAIRMAN—I welcome the representatives from the Bendigo Bank Group. We have before us your submission, which we have numbered 56. Do you wish to make an opening statement before we proceed to questions on the submission?

Mr Johanson—The committee will be aware that Bendigo Bank is a small regionally based bank. We are the only bank headquartered outside a capital city in Australia. We have been in existence for 140 years, substantially as a building society, and as a bank for the last five years. We are owned by 24,000-odd shareholders, virtually all of whom are small shareholders and most of whom live in regional Victoria and regional Australia.

We would like to use this opportunity today to describe some of the practical issues that could come out of some of the implications of this legislation as we see it. In the foreword to the explanatory statement, the minister says that it is hoped the legislation will help attract business into Australia for the benefit of all Australians. We are keen to ensure that the legislation does not make it harder to deliver basic transactional banking services to all parts of Australia and, in particular, the markets that we see ourselves serving; that is, regional and rural Australia.

Basic transactional banking is no longer a discretionary product for most Australians. In the days that Senator Cooney was describing, where people might have rolled up to a teller, a lot of those people were probably paid in cash and they may or may not have had a bank account. Today, a person usually needs a bank account to get paid and the ability of the bank to provide electronic transactional services or credit is an essential element in being able to do a lot of basic living in a cost-effective way.

Senator COONEY—I was thinking of the Commercial Bank of Culgoa. Can you remember that one?

Mr Johanson—No, I cannot remember that one, Senator Cooney. Perhaps it would be useful to give you a brief description of some of the ways that Bendigo is trying to deliver services to those communities. Let us take a particular example and think about the issues that this legislation might raise for that.

Bendigo, as you may be aware, is trying to deliver cost-effective services to regional Australia in a couple of ways. One is through a wide network of agencies and another is through connections with other institutions. In Tasmania, we have established a banking services business in joint venture with the Tasmanian trustees company. Through our joint venture with Elders and Elders Rural Bank, of which we own half, we hold the first of the conglomerate licences under the new legislation for banking. Through that, we are looking to provide some sorts of banking services through 330-odd Elders agencies throughout Australia, some which are large, complicated organisations but a lot of which are one- or two-person small office stock

and station agent-type things. How we are going to be able to deliver those banking services through that network is something that we need to work our way through.

Perhaps most famously, we have this community bank structure. I will give you a particular example. The first of our community banks was established with the communities of Rupanyup and Minyip, which are two small towns up in the Wimmera. They are about a half-hour drive apart. The townships raised some money—about a quarter of a million dollars—to establish their own bank branches. So they own the branch and employ the people, but we have management and franchise agreements with them so that we provide the banking product and the banking services to those people and do the training for those staff. That has been going for about 18 months now. Two days a week the Rupanyup branch is open, two days a week the Minyip branch is open, and on Fridays they are both open. We have six staff, two of whom are full-time, and there are four part-time people. We have about 1,600 accounts. We think we bank about three-quarters of the population of those two districts. Those businesses would not be viable unless we had that of penetration into that area. We do about $25 million worth of business—that is assets and liabilities—out of those services.

The costs of running those businesses are borne by the local community, and they make money out of sharing the margin that comes out of the business that they are able to get for their own branch. To the extent that we increase the costs of delivering those basic services, we will make that harder to deliver. That obviously applies across our network. If a person came into either of those branches and was seeking a sophisticated superannuation type product, or if such a customer knew of the availability of such a product as a result of dealing with that branch, we would expect and require those people to be dealt with by someone else. We need to have those communities bear the additional cost of training those part-time staff members in case someone does come in for those sophisticated products.

We are concerned that, if the definitional issues that have been discussed in the inquiry are so wide and open ended, everybody will—to be cautious—ensure that the highest common denominator standard prevails in each of those cases, and the additional costs on what are, on any basis, fairly marginal businesses, will simply become unavailable in those places. I guess that is the basic position we want to leave you with.

We believe that the sorts of products that we would see as being able to be dealt with by those trained tellers are, if you like, the capital secure type product that were discussed earlier. In our experience as a building society in Victoria, we were aware of other organisations, which have since disappeared, where much more aggressive selling techniques were used and much more complicated capital unsecured products were, in effect, sold as though they were banking products. In the case of the Pyramid Building Society and others, there have been plenty of repercussions.

So we are very sensitive to the issues and the goodwill between a customer and the institution that can get destroyed in that sort of process. We do not want to raise the sceptre of that happening under the guise of a loose definition of what is advice and what is information. Nonetheless, we think that there are basic capital secured and generally on-demand type products that can be dealt with without that level of highly sophisticated training which may well be appropriate to the risky and superannuation type products we were describing earlier.

The fact is if a customer is unhappy with their deposit account, they will withdraw their deposit. Even for a medium or short-term term deposit, that is in fact available. We do not see that those products require the level of sophisticated training and expense that would make it difficult for us to justify employing a part-timer in a branch for a day a week in a remote community like Rupanyip or Minyup.

Can I just pick up just two things that I heard in the discussion with the previous witnesses. The question was raised as to whether the courts and litigation was an appropriate way of dealing with uncertainties in definitions. The risk of litigation is a real problem for any service delivery of the nature of banking, and institutions like ours will go to great lengths to avoid the risk of litigation. A bank never wins in litigation, even if they win the particular case. If there is a real risk of litigation, that in itself is the cost; is not the actual outcome of the litigation that causes the cost. So the strong inclination would be to prevent the issue arising, rather than let the issue arise and be sorted out through litigation. Having wide or other loose definitions which can be only sorted out that way, is frankly unsatisfactory for us as a cost of doing business.

The question was also raised about issues of complaints on accounts. We do have complaints from customers, but generally where the complaints related to the conduct of accounts of the nature we are describing, as I say, if it cannot be sorted out, the customer withdraws that account. That resort is always available to them. It is not as though in these sorts of accounts the funds are locked up for long periods and are unavailable except through some other significant and costly resort sort of mechanism.

Perhaps I should just say one other thing and that relates to electronic banking. It is interesting that, while we have this large number of accounts and customers from these towns, the usage of electronic banking by those customers is as high as any others. But the ability for the depositors, in particular, to see that the commitment by the institution is significant and real through the establishment of local branching, or the connection with the community for local branching, and for businesses to be able to conduct their own requirements through a local physical presence, rather than themselves have to cart their cash a long way or bear the cost of that in other ways, are significant things. While we are happy to give to those branches the credit of the accounts held by local people where they join because of the local presence of the account, in fact a lot of them deal electronically anyway and we expect that that penetration of electronic banking, which is currently starting to be overwhelming, will continue to go on. But, again, that just underlines the difference, I think. Electronic selling is really only simply a way of dealing with the customer. I think the real distinction in the sorts of issues we are talking about relates to the nature of the account, rather than the nature of the transactions that sit behind it.

CHAIRMAN—Thank you very much. Do have any solution to this problem of the definitions of ‘advice’ and ‘investment product’? I drew to the attention of the Bankers Association the holding out provision in Canada and the response was that we still have not had sufficient experience of that to know whether it would be an adequate solution for our situation. Do you have any other changes to the definition?

Mr Johanson—The definitions, as I read them, are concentrating on what the bank officer or employee does and the way the bank officer or employee conducts himself or herself with the customer. If the definition actually related to the product being sold, then there might be less

ability for ambiguity. As I say, it seems to me that where a product can be described as, if you like, a capital secure account, which is really a deposit account, then if a person is enrolling a customer or giving advice in relation to features of such an account, a transaction account, ways of processing transactions or the features of such an account—that as opposed to my long-term superannuation thing—we can be clear. I am not suggesting that there will not be shades of grey in the middle there—a deposit account for a sufficiently long term, by its nature, becomes sensitive to interest rate movements—but, nonetheless, maybe there is opportunity to talk about the definition of the product rather than concentrating on the conduct of the employee.

As I say, we accept that if conversation in our Minyip branch turned to financial planning matters, that employee has no authority, nor the knowledge, to enrol or sell that customer that account, but if that employee were to provide that customer a brochure relating to such an account or an insurance product or some such thing, and referred them to a person from a financial planning service, then it seems to us that the reference relating to that should not fall within this definition, but the sale itself, if I can call it that, ought to. We have no qualms about a person selling that account in that way having to do it. We have a subsidiary which is a trustee company and we would expect that some of the trustee company products would be caught by this more rigorous regime. We would expect that probably in Rupanyup and Minyip our branch manager would need to be someone who was registered and appropriately qualified to enrol a person into that trustee-type product. We accept that, but we think that the cost of the training of that person to fit within this sort of regime will have to be borne. As I say, my other extreme is the part-time teller who hands over the brochure.

CHAIRMAN—Have you done any estimate of the cost of compliance if there is no change to the legislation as drafted?

Mr Johanson—No. We have a total of about 300 or 400 people operating in our branches.

Mr Oataway—It is closer to 500.

Mr Johanson—I would expect that as of today the overwhelming majority of those people would not be trained in the sense that this sort of level would require.

CHAIRMAN—Would not be up to a PS146.

Mr Johanson—There is a total cost and then there is a marginal cost. The instance I have been describing is the most marginal branch, if you like. If the part-time one day a week employee has to be trained, then that training cost becomes a very large component. A week or two of training for that person is a very large cost as a proportion of the total cost of employing that person. As a proportion of the total employment costs of the bank, it will underestimate the cost to the individual business. It becomes a marginal cost exercise to us, which in this case we share with the local town, the local community buying group. It will be a very significant cost to that group.

CHAIRMAN—What would be the consequence if there is no change to the draft? Would it mean some of those facilities would close and not be able to continue operating, that services would be withdrawn?

Mr Johanson—To the extent that any additional fixed cost is hoisted upon these distribution mechanisms, they become more marginal. For instance, a number of pharmacies provide our agency transactional services. The cost of having the pharmacist and staff trained up appropriately must become a more significant cost and so there will be less interest in selling it. In the Elders agencies—again, we hope that some level of service can be provided at virtually all agencies—that will be constrained because the banking products will be competing with other products for the attention of those staff members. I cannot tell you that X number of things will not open as a result of this, but I am sure you will appreciate—and there is plenty of evidence from the fact of the withdrawal from these communities of banking services—how marginal a lot of these businesses are. The models we are developing are to provide better penetration into the communities, more customer usage of those facilities and lowering the costs to the financial institution and, in the case of a community bank, where communities themselves share some of those costs because they value them accordingly. Any marginal additional to those costs make that business less likely to happen.

CHAIRMAN—We had evidence earlier from the union representatives—and you may have heard my reference to it in relation to the witnesses from the Bankers Association—that today pressure is put on tellers and counter staff to actually sell products to customers rather than simply provide a passive reactive service to the customer. Are you are able to comment on whether that is an accurate portrayal of the role your counter staff are required to play?

Mr Johanson—The need to sell more products to customers is a feature of banking business. If you could increase the number of products per customer by one, that would make a very significant difference to the distribution of business in a bank. Up-selling is a feature of not just banking but of all sorts of businesses, and they are all trying to do that. Our view would be that if a business—and a bank is a business—is requiring its staff to sell the sophisticated kinds of products that I have described earlier, then it ought to make its own calculations as to whether the cost of adequately training people to do that is worth it doing in that manner.

I think it is happening. It will continue to happen as financial institutions broaden their product range either by buying in products from other providers or by developing their own products in-house. That pressure will continue. It is part of the expansion of the product base. Senator Cooney's description of the old style teller's range was of a very narrow product range. In those days if it was a savings bank it was prescribed what the product was and what the interest rate was. Life was simple.

Senator COONEY—Do you remember those Commonwealth Bank tins?

Mr Johanson—You took it in and there was only one account that you could put the money in, as I recall it.

Senator COONEY—They would get a tin opener to open it and count the money out.

Mr Johanson—I think that up-selling will continue to happen. It seems to me that if those products are to be sold properly then clearly that seller ought to be caught by that legislation as well. I will go back to my definition. It seems to me that you can capture that by the characterisation of the product perhaps easier than you can by the characterisation of the conduct of the employee.

CHAIRMAN—But if in practice it is every front counter staff's job to do that, would that then lead to the conclusion that they do need to meet the training standards that are envisaged in the legislation of PS146, or are you saying that there is some lower level of training that most of these products relate to that do not require the sophistication of PS146?

Mr Johanson—For a car mechanic to be qualified we do not require that they be qualified to be able to service and repair every make of car. There is no point having a car mechanic in Rupanyup being qualified to service a Porsche because the Porsche owner will probably go somewhere else.

CHAIRMAN—There are no Porsche owners in the country these days!

Mr Johanson—For Holden or Ford, it is probably appropriate they are trained.

Senator COONEY—That is a great illustration. If there is a mechanic and he knows Ford and Holden well but you get him to say that the Mercedes is the great model, it is like the bank asking him to go into selling Mercedes, a vehicle about which he knows little. That is the real problem. Shouldn't the chemist or post office, or whoever it is who is going to do the job as an agent, do no more than speak about what they know, which is really taking a deposit and handing out money?

Mr Johanson—That is right, but if you require the mythical car mechanic in Rupanyup to be qualified to service a Mercedes and there is one Mercedes a year, or none, then all you are doing is adding to the cost of that operation. They will shut up shop and move to wealthy places like Ballarat.

CHAIRMAN—What if he is servicing as well as selling? Normally he is selling the Holden or the Falcon but the owner of the dealership might say 'I want you to sell a Mercedes. We can sell Mercedes through this agency as well. Try and upgrade people to the Mercedes.' Even though most of the time he is selling the Holden, is he going to be trained—

Mr Johanson—If they are going to sell a Mercedes then perhaps they ought to know something about it.

CHAIRMAN—That then becomes the issue. How do you determine what level of training an individual teller needs because one day they might be selling the Holden but the next day they might be selling the Mercedes?

Mr Johanson—As I suggested, if you are dealing with basic transactional banking products of the sort I have described, then we do not need to train them for the Mercedes.

CHAIRMAN—So you are saying is you would apply what we have called the holding out provision in Canada where they will sell the basic banking product but if they start discussing something more sophisticated then they will say, 'You have to talk to our adviser over here about that.'

Mr Johanson—Yes, that seems to me to be a workable solution. You will not stop them—and I do not think you should try to stop them—from providing information. We want those peo-

ple to have access to a broader range of products, so if there are brochures on the shelf about available superannuation products, they ought to be able to be there. But if a person ask, 'What is this? What can I do?' they should be referred to an appropriate person.

Senator COONEY—As the Chairman has been saying, the intention is to have legislation that covers all, but I just wonder whether we can cover all. As you said, the Bendigo Bank arose out of a building society and very much in association with the community, and therefore the culture, the philosophy, behind it is much kinder than the one you might expect to have in the four major banks. Whilst you might want them to meet the requirements, perhaps the Bendigo Bank, given its community presence—coming from the community, in effect, if I remember correctly—is in a different category. Have you spoken to Treasury about that?

Mr Johanson—I will not say anything about what you have kindly said about our organisation, Senator, but I am trying to find ways of distinguishing the sorts of things we are talking about. I am not sure the parentage of the organisation is going to be necessarily reliable.

Senator COONEY—The less regulation the better, if you can do without it, but every time that goes through my mind I think of the sexually transmitted debt era and all that sort of thing and just how all that happened. There was litigation arising out of that, and the little lady in the country who had the farm threatened and what have you, and you think you cannot leave this to self-regulation, that you have to have some laws in there to look after that sort of thing. The record has not always been good. The system tried to remedy that by saying that you had to get advice from a lawyer. I can remember guaranteeing somebody at one stage and having to get some advice, which I did. I got that advice from a lawyer who later became my daughter-in-law, so I suppose something good must have come out of that!

Mr Johanson—These are interesting examples, but the cost of independent advice is added, effectively, to the cost of the transaction, and the risk of litigation that the credit provider has, where the credit provider realises that these issues are alive, means that credit tends to get withdrawn or not offered in cases where those issues arise. We do not see the cost of that regulation, if you like. It is probably felt in ways we cannot measure, because we do not see where credit is denied in those cases.

Senator COONEY—That is right.

Mr Johanson—We had plenty of regulation of building societies in Victoria in the late 1980s. It was, on the face of it, quite intrusive regulation, but it was just unable to cope with the changing environment in which those regulated entities worked. Regulation worked in some parts and not in others.

I am concerned that to impose a tight regulatory regime on anything to do with finance will have its costs. If its costs are on the marginal members of society—in terms of the way that a bank or a transaction provider will look at them—in areas where the delivery of those services is marginal then you will see more and more withdrawal of those services. It seems to me that we ought to be only imposing regulation for products that are highly sophisticated where those are the actual products being sold. We should not impose the cost of that regulation in case a teller in Rupanyup happens to mention the superannuation product where they are selling a call

account and a cheque account for someone who sets up an account into which their pay might be put.

Senator COONEY—Why even mention that? If you are at Rupanyup or Minyup, why not say to the local football team, 'Thanks for your deposit. It was not that good but thanks very much.' The customer says, 'Can I withdraw $50?' He withdraws the $50 and there can be no problem about it. It is when you go into the selling of the product that the problem arises.

Mr Johanson—I agree with that. As I hear the issues about the definitional problems as between advice and information, we will inevitably end up categorising everything as, potentially, advice.

Senator COONEY—Why? If the system runs sensibly it shouldn't.

Mr Johanson—If the only way of sorting out the uncertain definition is by someone going off to court, where the consequences, both directly and indirectly, for the party are such that they will just avoid that, then that product will not be offered in that locality.

Senator COONEY—If everybody acted ethically—management, agency and all—you would not have to have any regulations. I suppose if everybody acted ethically you would not have the Ten Commandments. That is really what it is all about.

Mr Johanson—Everyone can be acting ethically but still get caught up in definitions which are too wide. Everybody can be providing the best customer service in the world and acting very ethically to allow their customers full knowledge. Otherwise, we could end up saying that people in remote branches should not be entitled to know about these things, and that is clearly not where we want to end up. Unethical behaviour—you can catch that. It is well meaning but mistaken or sloppy advice where the problems and real issues arise.

Senator COONEY—The other thing you could say is that it is also productive for litigation because people will give different accounts of what conversation took place.

Mr Johanson—It is long and it is expensive.

Senator COONEY—What I was getting at there is that it gives an occasion for people to quite innocently have different versions of what happened.

CHAIRMAN—Thank you for your appearance before the committee today. It has been most useful and insightful.

Proceedings suspended from 3.23 p.m. to 3.40 p.m.

KRUGER, Mr James Roderick, Lawyer, Equities Group, Macquarie Bank Ltd

CHAIRMAN—I now welcome the representative of the Macquarie Bank. We have before us your submission which we have numbered 29. Do you wish to make an opening statement in relation to the submission? If so, you may proceed and we will then move to questions after that.

Mr Kruger—I think I will rely on the purport of the submission at this stage.

CHAIRMAN—We had the Australian Stock Exchange giving evidence this morning. They raised a number of detailed issues. One of the issues they raised was the view that warrants and hybrids should fall outside the definition of securities and should come within the proposed disclosure regime of chapter 7.8. Do you share that view?

Mr Kruger—Yes.

CHAIRMAN—Why, in your view, should a broker be not required to give a product disclosure statement for secondary trading of listed financial products?

Mr Kruger—They are in the market and subject to market pricing requirements and the continuous disclosure regimes for the underlying stock, and the primary offering circular would be available at the ASX or the relevant exchange to describe the background and the terms of the issue if they did require that. The secondary trading of those securities is done by investors who know about warrant products generally. They would know about the underlying parcel, would see the market interaction for the pricing and would be able to get the original offer in the circular from the ASX. Much of the content of what is in the original offering circular, it is my submission, would not change from the time of issue to the time of secondary sale. What would change is the information about the underlying parcel—the company or the index for which the warrant relates.

CHAIRMAN—Can you just take me through your position on the various types of warrants and derivatives, some of which I understand from your submission you believe should be regarded as securities; others should be regarded as products for disclosures under the proposed regime.

Mr Kruger—Under the current Corporations Law, just by virtue of the definition of securities, some types of warrants are caught within that definition. Equity call warrants, which are in effect an option to acquire a share in a company, are in effect securities within that definition. They are securities because the current definition of securities includes options over issued or unissued shares—that is under section 92.3E, which includes as securities options by way of issue or transfer over shares. There is another type of warrant, which is generally an investment style warrant, which gives the holder of the warrant generally a two-year term in which they can acquire the underlying company. In the meantime, they get the full beneficial rights to the shares which, most notably, include the dividends and the franking credits attached to those dividends. So an instalment warrant holder is in effect a beneficial holder of the shares with the obligation to pay the last instalment price on expiry of the warrant. Instalment warrants are also caught within the definition of securities because they give the holder a beneficial right to the shares in the meantime.

Those two types of warrants—equity call warrants or warrants to acquire a share in a company and instalment warrants, which are more a type of investment or leverage investment vehicle giving an option to acquire a share in two years time and all the dividends in the meantime—are caught within the prospectus regimes by virtue of what is in the Corporations Law at the moment, whereas every other type of warrant, including warrants over an index or a currency or a put warrant, which is an option to sell or have a cash settlement on the fall in a security, are not caught within the definition of securities for which a prospectus is required and therefore they are out. To date this dichotomy has caused problems that ASIC has stepped in and solved by issuing various class order or product-by-product type relief to say that every type of warrant, whatever it is, is not something for which a prospectus is required. That solves one problem in terms of warrants classified as securities.

Another problem is their trading or their secondary sale. Warrants, as opposed to exchange traded options are settled through SEATS on the ASX market and through CHESS. Therefore, to take the benefit of the SEATS and the CHESS regime in the current Corporations Law, they have to be deemed to be marketable securities, and most of them are. Some of them are not—for instance, index warrants, because they just do not relate to a company at all. There is a different definition of securities for this purpose as well. So ASIC has again stepped in and said, 'All warrants, whatever they are, are marketable securities for which CHESS and SEATS can be utilised to facilitate their transfer.' So there are two problems facing warrants. One is whether they are securities for prospectus provisions and the other one is whether they are securities for SEATS provisions. The Corporations Law does not help uniformly in applying all warrants outside prospectus and all warrants within SEATS and CHESS. So ASIC has sort of patched it up and helped it out by class-order relief to that extent. We see it is now in the process—

CHAIRMAN—Is this under the existing legislation?

Mr Kruger—Under the existing legislation. We see it as an appropriate time, given the thrust in CLERP 6, to provide uniformity for disclosure and settlement to address this problem, rather than having ASIC step in in the background and fixing up in that sort of patchwork way.

CHAIRMAN—But the legislation, as it is drafted, still leaves the patchwork?

Mr Kruger—Yes, that is correct.

Senator COONEY—You described the wide variations that can occur over warrants. What is the thing that gives them a generic flavour? What is it that is the distinguishing mark? Why use the term 'warrant' when it might be better for the purposes of legislation to use other terms?

Mr Kruger—The common thread of all types of warrants at the moment is that they are derivative type instruments traded on the ASX that give the holder a right to acquire a stock or commodity or to receive a payment by virtue of the performance of the stock or commodity at a future time. Beyond that there is no common thread. There are many varieties. They can be trading warrants in that people can buy and sell them on the punt that the actual price in the warrant will go up or down. People will actually have them as an investment type vehicle and they will hold them for 10 years. After 10 years they will actually have to pay a certain amount of money and they get the shares or they hold them for two years and they get the dividends in the meantime. Apart from that common thread being that the ASX has recognised a derivative

type instrument and said that it gives the holder a right to either receive a stock or commodity or receive a payment on the underlying performance of the stock or commodity there is no—

Senator COONEY—How inconvenient would it be for the organisation you represent to simply say, 'We'll use other features of these various instruments to classify them rather than the word "warrant" and therefore we will be able to treat them in different ways?' Instead of saying, 'This is the distinguishing mark, this is what gives them the common feature,' you say, 'We will ignore what gives them the common feature and classify them according to other marks.' Those would, of course, be marks that distinguish them from each other.

Mr Kruger—I am not sure I entirely understand that question. I will just pre-empt it by a possible conjecture that it would not happen because warrants live and die on the ASX listing and are being treated as warrants, are recognised as warrants and have a badge of warrant for investors who get into them to recognise what they are and to start turning their minds to the issues.

Senator COONEY—In your submission you say 'all warrants'. Under 'Summary of submissions' you emphasise that all warrants should fall outside the definition of security and be classified as derivatives. In your last dot point at the bottom of that page you say:

Despite the above dichotomy, all warrants are not treated as securities ...

Mr Kruger—The last bullet point refers to what the Corporations Law wording currently is. By virtue of the Corporations Law wording, most warrants are out of their prospectus securities, but some warrants are inconveniently and perhaps inadvertently still within that definition of securities. That is why ASIC has had to provide the patchwork class order relief to make sure that all warrants are not treated as securities.

Senator COONEY—You are saying that the law would be much more effective if it treated all warrants the same.

Mr Kruger—Because ASIC has stepped in and provided class order relief, the law is effective because it does treat all warrants the same now, but that is the result of Corporations Law doing 95 per cent of the job and ASIC doing the last five per cent. The fear with leaving the status quo with the Corporations Law post-CLERP 6 is that ASIC will say that they no longer have they mandate to provide that class order relief because if it was meant to be addressed it would have been addressed by the legislators.

Senator COONEY—And you have discussed this with ASIC?

Mr Kruger—More ASX, but certainly we are in contact with ASIC and are one of the chief protagonists in getting the class order relief post-CLERPs 1 to 4. So things were changed a little bit on 13 March which required a different type of patchwork, if I can keep using that term. We are in communications with ASIC and are unable to represent that that patchwork has been provided in respect of that.

Senator COONEY—Is that one point that you want to raise?

Mr Kruger—Yes. I have been involved in the AFMA committee submission and defer to that general submission for anything else. I think we touched on the requirement to give a product disclosure statement in a secondary sale situation.

CHAIRMAN—Can you just expand on the nature of the confusion among investors? You say that there is likely to be confusion because you have some that are securities and some that are derivatives.

Mr Kruger—Yes.

CHAIRMAN—When you say there is confusion, I assume that the sorts of investors who are involved in the trading of these sorts of financial instruments are reasonably sophisticated investors. You would not get too many of your mum and dad shareholders, for instance, getting involved.

Mr Kruger—You could for instalment warrants or endowment warrants.

CHAIRMAN—Instalment warrants, sure, with Telstra and so on.

Mr Kruger—Yes, which are the ones that would be called a prospectus, as opposed to a derivative financial product statement. They are the ones who would be more likely dealing in prospectuses for the company itself and would see prospectuses for Telstra with a great deal of information about material contracts that Telstra deal in and the financial position of Telstra and its likely prospects and any financial projections that it has. That would be in a prospectus. We would today see a great absence of that in an instalment offering circular over Telstra instalment warrants. All you will have in an offering circular over Telstra instalment warrants is a two-page schematic summary of the financial statements issued by Telstra.

CHAIRMAN—I am just trying to remember what came out with Telstra2.

Mr Kruger—The Telstra 2 issue, as opposed to what Macquarie would issue over Telstra 2.

CHAIRMAN—Okay.

Mr Kruger—That Telstra 2 issue is really a security that gives—

CHAIRMAN—Even though it is called an instalment.

Mr Kruger—I do not know if it is called an instalment warrant; it is a Telstra instalment.

CHAIRMAN—It is an instalment receipt.

Mr Kruger—It is like a call on the shares over a term, rather than an up-front payment, and has the same features of an instalment warrant in that respect, except that it is issued by Telstra.

CHAIRMAN—Again, how many mum and dads are using that terminology?

Mr Kruger—Would get into Telstra instalments?

CHAIRMAN—Instalment warrants through Macquarie. Isn't it likely to be the more sophisticated investors?

Mr Kruger—It is still; that is conceded.

CHAIRMAN—Are you are overstating the confusion that might arise, given that you are dealing with people who understand the market?

Mr Kruger—I would put that point as the least strong point about why prospectuses and financial disclosure statements and splitting them for warrants would not be a good thing. I would put more strongly the director liability provisions, the different treatment between the requirement to give a product disclosure statement in indirect issues for retail clients under the proposed CLERP provisions, the 982, versus the requirements to give a prospectus in an indirect sale position for a prospectus in section 707. There are slight nuances and differences, one of which comes from the different definitions of a retail client for the purposes of prospectus chapter 6(d) and a retail client under CLERP 6. So there are differences when you have to give a PDS, or a prospectus in an indirect issue, which would create difficulties. On the one hand, if you have a warrant which is a prospectus, you have to look at section 707 for when you would have to give that prospectus in an indirect issue. You would have to look at the definition of 'retail client' for that purpose. If you have a warrant which is not a prospectus, an equity call warrant, you would have to look at the new section 982 and the indirect issue provisions there and the definition of retail client that applies to those sections to see when you have to give a PDS. That creates a working difficulty for the broker or the financial service provider.

One of the other points is that prospectus provisions have an emphasis on the financial position of the underlying security, the underlying company. So with Telstra you would have a lot more information in the material contracts and the directors' consents and the directors' interests in material contracts, than what a warrant is which is issued by someone outside Telstra—the Macquarie Bank, for instance—and only has a two-page summary of what the Telstra company is about and what its financial performance is and relies heavily on the continuous disclosure regime.

CHAIRMAN—Have you raised these issues with Treasury in the consultative process or have you not had that opportunity?

Mr Kruger—No.

CHAIRMAN—You do not know what their reaction is to dealing with this issue?

Mr Kruger—No.

CHAIRMAN—So you are relying on us!

Mr Kruger—Yes.

CHAIRMAN—Is the solution you propose a reasonably simple one? Does it create any other problems?

Mr Kruger—If we looked at the legislation today and said, 'Why don't we just draw a line through the securities definition and say that warrants are out?' the one problem with that is that we rely on the CHESS and national guarantee fund provisions and are also happy to be caught by the securities licence provisions to say that warrants are securities for those areas. Under the current law, we need to have warrants as securities for the purposes of transferring things through CHESS. We need to have warrants as securities for CHESS, for the national guarantee fund and for the securities licence provisions. We have not had an easy solution to it to date because the Corporations Law is structured in such a way that securities are here, futures are there, and there are different rules for transferring and market licences, et cetera. The advantage with the CLERP legislation is that it provides a greater scope for the NGF and the transfer of title provisions to apply more broadly to financial products. Therefore, we can then say that warrants will not be securities for prospectus requirements and they also do not need to be securities for the other requirements because the other requirements can catch them by virtue of their being financial products. I believe that is the case.

Senator COONEY—Take us through your suggested amendment to 982B(3). This is the obligation to give a personal product disclosure statement. You want to add some words to ensure that you are talking about a regulated person.

Mr Kruger—There are warrants issues at the moment which are structured such that Macquarie Bank would be the issuer and they would sell them in effect to another investment house or somebody like Challenger Bank or Challenger Investment Nominees, who would then issue them to the market. In effect, they are issued to another regulated person and then they are on-sold. This section is trying to catch that situation—when a challenger or another regulated person takes the issue and then on-sells them to the market and is really the primary issuer, in effect. That structure does exist for a number of endowment warrants, in particular. I understand that the Challenger type person would be required to give a financial product disclosure statement. I do not believe there is mischief in a secondary sale situation where a broker or a regulated person is advising somebody to buy securities which are listed securities or are traded on the market, for which an original offering circular would be lodged with the relevant market provider and for which there is continuous disclosure and market prices forces working for that. If a broker had to advise on products which are in that category which are listed, then it becomes too overtooled in the sense of the documentation that it would need to be thrown to the potential investor.

Senator COONEY—So, if a person has a retail client and makes an offer to a regulated person to acquire particular financial products from the regulated person, the regulated person must perform its own — Does that add much?

Mr Kruger—I do not know if it adds much or clears up the paranoia that is just in my head.

Senator COONEY—Fair enough; that is more than a good reason.

Mr Kruger—The corollary to that is the carve-out for secondary sales of products that are listed on a relevant exchange, which is the second aspect to my submission in that regard. That

relies more heavily on my points about it being a listed product and subject to market forces, and already having an original.

Senator COONEY—You have been over your proposed amendment exposure draft. You would favour the proposition that removes warrants from the definition all together.

Mr Kruger—Again, I have a paranoia—I do not know whether it is just in my head or whether it could be more real—that ASIC would say, 'We are disinclined to give the relief that we have given to date because we are giving the relief on a newly drafted and well thought through piece of legislation. If it were intended to be that way, they would have made it that way.'

Senator COONEY—Yes, particularly since everybody has come along and made their submissions.

Mr Kruger—Yes.

Senator COONEY—Fair enough.

Mr Kruger—I believe the opportunity is now there to do that because of the NGF and the licensing requirements more broadly applying to financial products than just to securities, such that we no longer need warrants to be securities for any purpose.

Senator COONEY—I think we have had this evidence from another group as well. Macquarie Bank Ltd does a lot of dealing in warrants, does it?

Mr Kruger—Yes. At the moment we are the No. 1 market issuer by a good stretch, although the international banks are murmuring about coming in here.

Senator COONEY—I do not think I have a complete understanding of warrants even yet, in spite of the quite lucid explanations by yourself. Why isn't that instrument more widespread in Australia? From what you say, it is widespread overseas.

Mr Kruger—It is. I might just show you a graph which shows the increase in volume of these things. These lines show the value of warrants in the last couple of years and the volume of warrants traded. It shows a significant upturn in the last four or five years. They are a modern, new and growing phenomena. That line is projected to do that for a while.

CHAIRMAN—Would you like that to be incorporated in *Hansard*?

Mr Kruger—Yes, I can give you this document.

CHAIRMAN—Is it the wish of the committee that the document be incorporated in the transcript of evidence? There being no objection, it is so ordered.

The graph read as follows—

Senator COONEY—What has led to their adoption? Is it just that they are a very good product, as people would say? Or has there been a change in what people need in terms of financial assistance or financial products in this area?

Mr Kruger—I think investors have become a bit more sophisticated and therefore a bit more needy. They see the opportunity that warrants provide, which is a leveraged type position into the share market. You can take a position on $10,000 worth of ANZ securities. If you think that that amount of securities is going to go up, you can buy a warrant for a fraction of the price and have to pay it at the end, when you have made your money, or you can trade in the meantime. You can take a position over $10,000 in ANZ securities by paying $500, so it gives you that leverage in and exposure to a greater upswing but also a greater downswing in the underlying parcel. There is the benefit of leverage and the benefit of trading but also, longer term wise, with the ones that can go for 10 years, there is the benefit of not having to pay all your dough until the expiry or over a longer term. In effect it is like borrowing money for the securities.

Senator COONEY—Where did it start off? The point of asking you that is that I was then going to ask: how has this worked in the country that it started off in?

Mr Kruger—I do not know the answer to that question. It started here in 1991, just by looking at this. I know that it is significant in European, Hong Kong and Japanese markets to a level of regulation and product disclosure that we currently—

Senator COONEY—I was then going on to the obvious question that it is part of the global giving and taking of securities and marketing in these sorts of products. In other words, Australia is simply joining the worldwide trend.

Mr Kruger—Yes, I think that is fair comment. They are called warrants overseas—and they are a significant product—by Macquarie and overseas institutions.

Senator COONEY—Thanks.

Proceedings suspended from 4.11 p.m. to 4.18 p.m.

CHAIRMAN—Mr Kruger, can you make some comments for us in relation to the definition of a warrant?

Mr Kruger—When we are talking about warrants being carved out of the definition of 'security', I think it is important to note that there is no current definition in any of the legislation that we have, or even in the Financial Services Reform Bill, of 'warrant'. I would submit that it is appropriate to rely on the current definition of 'warrant' as the ASX sees it. That definition sits in chapter 8 of their business rules. I will briefly read out that definition:

A warrant means a financial instrument giving the warrant-holder the right:

(a) to acquire the underlying financial instrument in accordance with the terms of issue and warrant rules; or

(b) a financial instrument giving the warrant-holder the right to require the warrant issuer to acquire the underlying financial instrument in accordance with the terms of issue and warrant rules; or

(c) to be paid by the warrant issuer an amount of money to be determined by reference to the amount by which a specified number is greater or less than the number of a prescribed index.

Senator COONEY—I take it that this is a development and that there are developments going on in this area all the time. Would that be a reasonable statement?

Mr Kruger—There are new products being developed all the time. For instance, three or four years ago there were no warrants over foreign currency and now you will see warrants that have a characteristic or an option over a foreign currency or a Standard and Poors index. In 1997 they did not understand the concept of a warrant over any index. That was something that had to be grappled with and was dealt with at that time. They are continually changing—to the point where new things or new underlying financial instruments are being encapsulated into a warrant product and the terms are being triggered, changed, adjusted—and there are slight variations all the time.

Senator COONEY—We have to deal with this concept of change in information technology the whole time. Is the same sort of thing happening with instruments and with this area we are talking about now? You have told us about warrants. Is it likely that other instruments—for want of a better word—might be developed?

Mr Kruger—Yes, but this definition of warrants is broad enough to cover new types of developments. The definition talks about underlying financial instruments. It talks about warrants or option contracts over a financial instrument. The definition of an underlying financial instrument is an equity security, a loan security or a prescribed share price index, currency or commodity. They are shares, indexes, currencies or commodities that the ASX recognise and prescribe as being something that can be an underlying financial instrument caught within the definition of warrants. The things that warrants can be over could change; so that definition of 'underlying financial instrument' needs to be dynamic enough to accommodate that. At the moment it is, in that it talks about prescribed share indexes, currencies or commodities. That is a fairly broad parcel of things prescribed or being prescribed by the ASX, and the ASX can move fairly quickly on those things.

Senator COONEY—Thank you very much for that evidence, Mr Kruger. It has been very helpful.

BLACK, Mr Stuart, Chair, Rural and Regional Issues Group, Institute of Chartered Accountants in Australia

MOLYNEUX, Ms Anne, Director, Intellectual Capital, CPA Australia, Institute of Chartered Accountants in Australia

PRAGNELL, Mr Bradley John, Superannuation Policy Adviser, Intellectual Capital, CPA Australia, Institute of Chartered Accountants in Australia

REILLY, Mr Keith, Technical Consultant, Institute of Chartered Accountants in Australia

CHAIRMAN—I welcome representatives of the Institute of Chartered Accountants in Australia and representatives of CPA Australia. We have before us your joint submission which

we have numbered 10. Do you wish to make an opening statement in relation to the submission before we proceed to questions?

Mr Reilly—I might just point out that we have made two submissions: one to the joint parliamentary committee dated 14 April and then there was a later submission that we made to Treasury dated 17 May. Both submissions are fairly consistent. With respect to the submission dated 17 May we had a little bit more time to just amplify some of the issues. So I will refer to the 17 May submission, if I may. I am happy to leave a copy of that here. The team from the accounting bodies includes Stuart Black. The reason that Stuart is here is that Stuart is a practitioner and is very much involved in providing financial advice to business, both large and small. Whilst Stuart's practice is based in Sydney, he spends quite a lot of time in rural Australia. So he is aware of particular issues there.

I would like to reiterate our broad support for the proposed bill. We have been involved in discussions with both Treasury and government for some period of time on reform of the Corporations Law and, in particular, of the Financial Services Reform Bill. We have made previous submissions on the predecessor to this current bill, which is the CLERP 6 legislation.

We believe that one issue that does still require a degree of clarification is the definition of just who is required to be licensed. We have spelt out in some detail in our submission particular issues that we believe are relevant there. We have taken the broad view that, as with the current Corporations Law, if you are providing specific financial product advice, there is a good case to be made for a licensing provision to be put in place. Our membership comprises over 100,000 professionally qualified chartered accountants, CPAs. Of that number, only a small number are currently licensed—we would estimate it at somewhere between about 2,000 to 4,000. Under these provisions, we believe that that probably should remain as it is. But we do caution the committee—and we have had long discussions with Treasury staff in the past—that if those provisions are not quite clear then you will run the risk of requiring quite a number of our members—in fact, we would argue all 100,000-plus—to be licensed, because if you are a professionally qualified accountant you are tending to give financial advice on a day in, day out, basis. Even as the auditor of a large corporation, where you are specifically required to be registered under other complementary Commonwealth legislation, you are giving financial advice as the board requires and asks for your expertise in particular areas. We would argue that certainly the intent of the securities legislation, the current Corporations Law and the Financial Services Reform Bill would not be to capture those types of people.

Senator COONEY—Can I interrupt? Yesterday, it was suggested that accountants and lawyers ought to be covered by this. I forget specifically who it was but someone said, 'If you are going to license people, then everybody should be licensed.' So it is a fair point you are making.

CHAIRMAN—They were opposed to exemption. Who was it—the insurance brokers?

Senator COONEY—It might have been the financial advisers. I had better check that.

CHAIRMAN—It may have been the FBA.

Mr Reilly—We will comment later on the incidental advice exemptions that are in the current Corporations Law. We would argue that if you already have a license and regime in

place for, say, tax agents or for company auditors then it is silly to have another mechanism in place as well. I would have to go back and check just who was giving that evidence, but I would suggest they were probably questioning the incidental advice exemptions under the current legislation.

Senator COONEY—There was then a discussion on this—not necessarily with that group. I am only going on recollection, which is not too good these days! People then started talking about overlap and all that sort of stuff that you would no doubt know about.

Mr Reilly—We will provide some further comment on that. The other point I would like to make is that we do support the provision in the proposed bill for declared professional bodies which enables ASIC, the regulator, to declare professional bodies that meet certain criteria to have a responsibility in the licensing world. We are satisfied that ASIC would be able to implement such a system and to regulate that system as such. I might hand over now to Brad, who perhaps might provide some more detail on some of those issues.

Mr Pragnell—The provision that Keith was referring to is proposed section 882 in Corporations Law, which would enable ASIC to nominate specific organisations to act as declared professional bodies. In being nominated a declared professional body, that organisation would need to meet some rather stringent requirements in terms of its ability to discipline its members, suspend its members and have complaints resolution schemes, codes of professional conduct and so forth. It appears as if the Financial Services Reform Bill would allow provision for that so that ASIC could anoint certain organisations to act as these declared professional bodies. This provision is well in keeping with one of the recommendations flowing from the Wallis final report. On page 275, the report states:

> Professional advisers such as lawyers and accountants often provide financial advice. This advice is typically provided in the context of broader advisory services offered to clients extending beyond the financial sector, often where the adviser has a wide appreciation of the business and financial circumstances of a client. In such cases, the best course is to rely upon the professional standing, ethics and self-regulatory arrangements applying to those professions.

We see section 882 and the declared professional bodies provisions in the Financial Services Reform Bill as very much following through on that final recommendation in the Wallis report. I might just leave it at that. We do deal with that issue and a few other issues regarding licensing and disclosure in our submission and we are more than happy to take any questions on that.

Senator COONEY—I have a section 882A here.

Mr Reilly—That is the section.

Mr Black—I would like to explain to the committee the importance of the Financial Services Reform Bill as it affects accountants in practice. I think this has been forgotten in the past. An accountant's primary responsibility to his client is to build the client's wealth. That goes from building up the wealth of his business to on a macro scale increasing the wealth of his family. Traditionally, accountants have provided financial advice. It takes all forms. It takes the form of reducing expenses, one of which of course is tax; increasing income; looking at the spread of the family's investments; looking at the business opportunities; and evaluating businesses. It is a very wide ranging brief and I would argue that accountants are the first line of defence for nearly all small businesses in Australia as to where they look for financial advice.

To fulfil that role, when you look at a typical public practice, you will find that accountants offer a whole range of services which the public often do not see. There is a perception out there of an accountant being a bookkeeper or a tax agent, and certainly there are a lot of those around, but the vast majority of practices these days provide a whole sweep of areas of operations.

In our own practice we provide business development. That includes things like strategic business planning; profit improvement programs for small businesses; marketing assistance; helping doing budgets and projections; and management accounting advice. We also do business appraisals; share valuations; due diligence reports for purchasing new businesses; and litigation support. We provide financial service advice to clients in the way of evaluating financial options to them; financial planning; superannuation advice; estate planning; executive planning; and succession planning. Also, there is the traditional compliance in tax. We do statutory work, audit work, tax advice, and company secretarial work. We are also, these days, into information technology with accounting systems, networks, operating systems and communications.

So the areas of expertise provided in a typical accounting practice are very wide. We basically provide financial advice to business. That is where in the past there has been a large degree of confusion because the term 'financial advice' has been limited very much to advising on securities. That is all very well when you take the context which everyone has of saying, 'We're talking about listed company shares or listed unit trusts,' but everyone seems to ignore the fact that it impacts the day-to-day work that we do in small business. When we look at any company shares, it impacts that. That is a security.

It has actually been a case where to date accountants have been forced to operate in a world of uncertainty as to whether we comply with the Corporations Law. There is a great deal of uncertainty. Even the ASIC, at present, in its policy statements cannot interpret what the incidental advice provision means. There is legal advice that we have had at numerous professional seminars that all differ. There is no case law on the matter of what it is. So you have got these accountants offering advice, trying to do their best, but really having no idea whether or not they comply with the law.

A real risk for clients and a problem for every accountant is that if we give advice which is subsequently found to run foul of the Corporations Law, our professional indemnity insurance is then invalid. That basically means the client misses out because if we do give wrong advice the client has every right to expect to be able to collect on the professional indemnity insurance. But as it stands now there is a loophole so wide that insurance companies can step aside and say, 'You breached the Corporations Law. Your professional indemnity policy isn't valid.' We cannot continue that way.

As Chairman of the Rural and Regional Issues Group, I have been talking to numerous accountants in rural Australia and their problem is even greater. They do not have, as their city cousins do, a number of specialist professional advisers to give advice on investment decisions. In many country towns the only financial adviser is the accountant. When a client comes in and wants advice he does not have the choice of going and talking to investment advisers or to other professionals. The accountant has to be in a position to provide that financial advice.

Under the existing legislation the two key provisions are section 780, which is the business dealing in securities, and section 781, which is providing investment advice. It is interesting when you look at those. They are framed, as I said earlier, towards big business. The definition of dealing in securities is basically anything dealing with shares—in a very simple format. The same thing with providing investment advice. People considered, when they did that, that they were trying to protect investors in regard to public companies and tax schemes, areas like that. They forgot that it actually impacted everything which happened on a day-to-day basis. That is the problem with the existing legislation and something which must be addressed in the new legislation.

The incidental advice provision which was mentioned earlier has been the catch-all. It only applies, interestingly, to investment advice. It never has applied to dealing in securities, which is a problem in itself. In regard to the investment advice it has been the mechanism which has allowed people to hopefully—and I say hopefully—stay outside the Corporations Law. But it has not really done that.

I would like to illustrate the problem by giving a couple of examples that face a typical practice. These are the ones which we face all of the time. A primary producer approaches his accountant for advice on the desirability of hedging his crop. Any advice which is given that refers to specific future markets, timing of investment or price trends would breach the legislation at present. If a cocky comes in who has his cotton harvest just about to come off, it is an accountant's role to help that bloke in his business and advise him how to manage his risk. Accountants must be free to provide that type of advice.

Take another example. After selling his business, a client comes along to his accountant for advice on how to invest the proceeds for his retirement. The accountant looks at his estate and tax planning aspects. He looks at how he can provide for all the family members. He looks at the asset allocation as to how the asset should be spread out to provide the desired level of income and capital growth for the family and also to maximise the tax benefits and pension entitlements. The first part of it, the estate and tax planning, to date would probably be covered under the incidental advice provision. Incidentally, you cannot charge for that. How many accountants are not going to charge for that advice? So effectively the provision does not stand. The advice given in regard to the allocation strategy is clearly investment advice. But ASIC as it presently stands under Policy Statement 119 says, 'Yes, we know that but we will ignore it.' Now we have legislation about which the legislator says, 'It is obviously unworkable—we will ignore it.'

You then go on to give advice on the particular product that that person will invest in. The client may not want to invest in public shares or listed trusts. He may say, 'I have been a plumber all my life. I would like to invest in another plumber down the street who I know is going pretty well. I will give him a bit of advice and I will make my income out of that.' The accountant then has to evaluate the value of the shares in that business—once again a breach of existing legislation. Who else is going to evaluate that small plumbing business? No-one else out there is going to be able to sit down and evaluate whether that share is worth that price. That is what accountants do every day.

Another example is year in tax planning. Something happens every year this year and most likely it has happened to you. Your accountant says at the end of the year that you have a large

capital profit on some shares, and says, 'You have some shares in there which have losses. You would be wise to sell those shares, realise the loss and offset against the capital gain.' The accountant has given advice in dealing with securities. The advice was given purely to maximise the wealth of the client. It had nothing to do with the securities themselves. In many cases the client would have sold those shares and bought them back again at the lower cost base—one again a breach of the legislation.

The small client has his accountant prepare a business plan. That business plan is later used in the form of an information memorandum to attract someone else to invest in the business. Once again, is it a breach of the code? Under the present legislation and the legal advice we have seen, the answer is probably yes.

Another example is when an accountant is asked to value the shares in a family company because there is a dispute between the parties—it may be a divorce matter—once again, valuing the shares is a breach of the legislation. The funny thing is that an accountant can actually advise and sell a business but he cannot sell the shares in a business because they are securities. It does not make sense. If your client asks you to negotiate the sale of shares in the company, once again, because they are shares in the company, it is potentially a breach of the legislation.

These are only a very few examples of how the legislation impacts upon accountants giving advice every day of the week. It is obvious that the legislation, as it is drafted, does not work. It is also fairly obvious that the legislation, as it is put forward now in the draft explanatory memorandum, most likely will have difficulty in working for many of the same reasons. The problem is that you cannot license to protect a very small area of the law without impacting upon a wide spectrum of other services being given. I think it is important to remember that accountants probably are the first line of providing financial advice to the majority of people out there. They must have certainty—whether it is by the previous incidental advice exemption, which needs to be expanded and made very clear as to what it is—that they can give that advice to their clients and their clients can expect that they can get a one-stop shop advice. That is all I would like to say.

Ms Molyneux—If I may just sum up a bit of the position from my perspective. We endorse the flexibility of the legislation and the consolidation of the licensing regime. Certainly, in terms of the declared professional body situation, we would suggest that professional bodies come from a very long history of coregulation. We actually have self-regulatory mechanisms in place and we can see a real role for ourselves and our professionalism in this legislation. I think it is of concern, and we would suggest that the standards by which ASIC would administer any declared professional body provision must be developed in full consultation with us if they are to be applied in realistic situations–the nature of situations that my colleague has outlined. Certainly, as defined in the legislation, a declared professional body is not a carte blanche for accountants; it throws considerable responsibility upon us and requires us to monitor our members very closely so that it is not seen as a carte blanche if it were put in place.

Mr Pragnell—Just to reinforce that, I think any argument that it creates an uneven playing field—which I suspect is what was being raised yesterday—is totally misplaced. There are some very strict requirements on the professional bodies that do become declared to meet some very strict standards, and ASIC would be able to place very stringent requirements on a body to attain that status. It is very clear in the explanatory memorandum that this actually seeks to

create a much more objective, transparent and neutral regulatory outcome and to try to better mesh the regulatory regime within the Corporations Law and to ensure that the self-regulatory processes of professional bodies, such as CPA Australia and the Institute of Chartered Accountants, basically work in harmony so that there is no unnecessary duplication and overlap.

Ms Molyneux—We do have one final concern that, if the legislation goes forward without clarification of the Hughes case, there could be considerable difficulty in terms of implementation.

CHAIRMAN—Thank you very much. On that last point, we are all aware of this overriding uncertainty of the re Wakim and Hughes case. I think some work is being done to try to sort that out with the couple of states that seem to be resisting a referral of powers. We will see what happens with that in due course. Mr Black, from what you have said, you are of the view that the range of roles undertaken by the accountant, which you outlined, goes further than the concept of incidental advice, which has previously been the principle—

Mr Black—To be an accountant you basically have to provide financial advice, and it is a broad ranging piece of advice which cuts right across, under the current legislation, incidental advice. ASIC's explanation of what incidental advice is is quite unsatisfactory as it stands at present. In principle, one point is that you cannot charge for it and that no-one can give advice if they are charging for it—or that if they do it is worth what it is charged for.

CHAIRMAN—Is your concern with the draft bill that the way in which it enables ASIC to make a professional body a declared body is inadequate?

Mr Black—I think that is one of the answers, but I do not think the draft bill really addresses the question. It is focussed very much on the question that we are trying to protect shareholders on advice principally on listed securities and listed trusts. It thinks of the Joe Blow who goes along and buys some BHP shares or some BT Trust investments and the giving of advice in those areas. No-one has actually thought that it goes well beyond that; that everytime we talk about a security we are not talking just about a listed company security; we are talking about every little private company in Australia. That is the security. Therefore all of these things which are happening seem to have been forgotten because the legislators have focussed on one particular area and not realised what they are really doing on everything else.

I do not think the new legislation is a lot different in that regard. The best way to say it is to accept that accountants and other professional advisers do give professional advice and that possibly, provided they meet the requirements of their professional bodies, they will be covered. They have insurance, quality review and peer review, and that they are really being legislated or looked after at that point of time. But that is really not the way I see the focus of the bill. It is still being focussed very much on giving advice on securities.

CHAIRMAN—What is your solution to that problem—not to go down the path of the declared professional body?

Mr Black—The declared professional body gives the ability for one to step out and say, 'With ASIC, let the professional bodies look after it and negotiate with them.' So it is maybe a step aside; I do not think it is an ideal solution. One possible solution would be to say that you

limit the legislation to listed securities, because that is really what I see a lot of it as being focussed towards. I will be honest and say that, in the time frame I have had, I have not had a chance to go through the bill in detail. My experience has been more on the existing legislation and the problems there. But the parts that I have looked at in the bill do not seem to necessarily resolve it much differently from the original CLERP 6.

Mr Pragnell—To reiterate Stuart's point: we did raise in our submissions concerns about the very broad definition at section 766B(1)(a) where financial product advice is basically a recommendation, a statement of opinion or an interpretation of information or a report of any of those things 'that is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products'. That is very broad and it does, as Stuart mentioned, capture a lot of types of advice that are given, whereas the intent of Corporations Law was very much meant to look after securities. In a sense, if this bill does carry forward in its current form and we do have such an all encompassing definition of advice, it will become even more paramount that some sort of carve-out for accountants is maintained under 'declared professional bodies' because it would then capture a lot of the circumstances that Stuart was talking about. Obviously, there is room for considerable discussion between the professional bodies and ASIC, if and when this bill gets passed and the new regime is introduced, to make sure that 'declared professional bodies' is done in a very clear, transparent and competitively neutral fashion. We would go into such discussions with the regulators with the best of intentions.

CHAIRMAN—This bill goes a lot further than just dealing in securities.

Mr Pragnell—Yes, it does, very much so.

CHAIRMAN—In fact, I would have thought securities was a relatively minor part given that there is a whole range of financial products.

Mr Pragnell—Yes, definitely—very broad and very inclusive, and I think that is something that needs to be considered.

CHAIRMAN—But surely you are not suggesting that you cut it back purely to listed securities?

Mr Pragnell—I think we are arguing that it needs to be clarified quite clearly because there are certain grey areas. Stuart has mentioned the instance of unlisted companies and there may be some consideration there. Another issue would be self-managed superannuation funds, for instance. To what degree are self-managed superannuation funds captured and is there any advice given in regard to that? It is very unclear when you read the superannuation. You would assume that you would have to be licensed if you were giving advice on that product.

CHAIRMAN—I would have thought so if you were giving advice as to what the fund should be investing in.

Mr Pragnell—Maybe. I think the bill would capture both of those.

CHAIRMAN—So perhaps if you were giving advice on the structure or setting up the structure.

Mr Pragnell—Or even the type of product. That is where the concern is when you look at section 766B(1)(a). For our members, if we get the clear professional body and if it all works out the way that we are anticipating, it may not necessarily affect us dramatically. But, in terms of section 766B(1)(a), a recommendation, a statement of opinion about a class of product, is it financial product advice to say, 'I suggest that you set up a superannuation fund'? In terms of what we said in our submission, it could be. If you said, 'I suggest that you set up an allocated pension' or even if you recommended in regard to asset allocation, are they captured? I think that needs to be very much clarified. Because it is an all-inclusive definition, do we need to think through about whether it is overkill or whether it captures? By trying to be all-inclusive and in trying to capture everything, does it capture too much? Does it actually capture things like structures? Does it actually capture things like asset allocation? That is something that needs to be thought through. Unless you fall into one of the specific carve-outs—I cannot remember the section at the moment—you are potentially capturing. I think this runs counter to what ASIC is trying to do in other areas.

For instance, on the plane I was reading the ASIC discussion paper on consumer education that they have just released. They talked quite a bit about the role of professional, industry bodies and community groups in providing advice to consumers—very broad general advice—about setting up their financial affairs and becoming financially literate. If you do a close reading through the Financial Services Reform Bill, some of those people could be captured. We have to think through very carefully the way in which the bill is structured. If we are going to have very inclusive definitions, we have to be very careful about the carve-outs so that it is ultimately workable.

CHAIRMAN—As I assess the bill, in summary, it deals with two aspects. It deals with financial products—

Mr Pragnell—Yes.

CHAIRMAN—It says that, if a financial product, in essence, is a risk product, it should be captured by the legislation. That is where we have this debate now about some banking products that are not deposit taking and whether that comes within the definition or not. Certainly, if a product clearly is a risk product, it should be captured. Then you are talking about the sorts of people who should be captured by the bill, as distinct from the products, and where you draw the line there. In terms of what the intent is, I think it is appropriate that those products get captured—

Mr Black—I could comment on that.

CHAIRMAN—but it is a matter of where you draw the line in terms of what people get captured, isn't it?

Mr Black—Yes. It is also the products as well. To give you an example on the products, once again it is thinking of the big end of town and the products when you talk about a bank product or a life insurance product. Take a typical accounting practice or a typical small business, quite

often they want to raise money. They do not have money to go to the stock exchange and they do not have enough to go and raise capital. What happens is that the accountant will put together another investor or find another investor. That is a risk product; it is a financial product. If this legislation goes through, you basically rule out for any of those companies to obtain any finance other than a straight bank finance, because none can afford to get a prospectus and none can afford to get an investment adviser to go through and evaluate the product. In fact, most licensed investment advisers would not have the ability to evaluate it. It is not like BHP getting in a massive merchant bank to spend a couple of million dollars to evaluate a takeover offer.

CHAIRMAN—Yes, but if one way or another an accountant is licensed, whether that is because the professional body is licensed or whatever, then doesn't that overcome that problem?

Mr Black—Provided they can cover that product, yes.

CHAIRMAN—So, again, in that area I think you are getting back to what people can be involved. I would hate to think someone takes equity in a small company without getting some sort of appropriate advice about it.

Mr Black—That is what we really have to protect, that they do get advice.

Mr Pragnell—We are not arguing against that, that's for sure.

Mr Reilly—With regard to the superannuation area, our submission particularly draws attention to the need to clarify clearly what is the intent of the legislation and the way it could be drafted. We actually say that, with the choice of funds coming in, you would not want to have to require every employer who runs a superannuation fund to in fact be licensed. The employer is sponsoring that fund. The fund itself is then going to the individual at large to get advice as to what sort of investment should be there, and clearly those people are licensed now and should continue to be required to be licensed. But the way the wording at the moment is in the bill, there could be some argument to say that if you are sitting on the board as a trustee, the employer trustee—or employee trustee even—you are giving advice on a financial product. So that is where we think clarification is needed.

In discussions we have had with ASIC staff in the past, they have said that, yes, they would envisage that there would be appropriate rulings and guidance being brought forward and that that would be done in consultation with various industry bodies. We do believe that if we can, it would be better to get the legislation clarified by way of explanatory memorandum to make it clear what the intent is rather than by giving it more work to Alan Cameron's team.

CHAIRMAN—Have you raised that issue with Treasury?

Mr Reilly —Yes, we have.

CHAIRMAN—What was the reaction at that level?

Mr Reilly —Treasury, I think, have been receptive to the issues, but we have not really received an appropriate response to what series of wordings we should have in place. Through

the whole CLERP 6 process we have argued quite clearly that there needs to be clear clarification, because at the moment the incidental advice exemptions, with ASIC taking a fairly narrow view and the accounting bodies taking what Stuart has said is a fairly pragmatic and practical view, do create problems.

In looking at why ASIC has not taken action on incidental advice, ASIC has concentrated very much at the end of the market which has been what we would call the 'unprofessional' end of the market. Our members are required to comply with a myriad of requirements—educational, continuing education; we have a periodic review of practices—and so it is our members who have tended not to have been involved in having their clients running into problems. But, at the same time, the legislation does need a degree of clarification there. That is why we have been quite supportive of the Wallis recommendation that says that those who are appropriately professionally qualified and who have not run into problems in the past should continue to be able to provide that level of advice. Otherwise, you get to the stage where in country regions, in country towns, you just do not have anyone, apart from the accountant and perhaps the legal adviser, who has an appropriate business background.

Senator COONEY—You say that if you are a fully qualified accountant, you should not have to get a licence. If you put it around the other way, is there any great trouble in getting a licence? I suppose once you say, 'We are going to excise this group from the requirements,' then it gets more difficult to administer in some ways.

Mr Pragnell—Some of our members have chosen to acquire investment advice and security dealers' licences, and several thousand of our members do hold proper authorities with licence holders. They have chosen to do that to, in a sense, opt in so that they can basically have an infrastructure behind them that allows them to give advice primarily on listed securities and managed funds and also so that they have the administrative and compliance support behind them to do that. Some of that growth has arisen, on the one hand, probably because some of our members have chosen to specialise in the investment advice area and to function more as financial planners; on the other hand, I think some of them have entered those arrangements because of the uncertainty that has come about because of ASIC's interpretation of 'incidental advice'. They were never sure if they could give certain types of advice with or without a licence or whether or not that was covered by 'incidental advice', and I think this bill is trying to provide a bit of clarity and certainty in terms of the principle of a declared professional body. 'Incidental advice', under the existing Corporations Law, has created quite a bit of confusion out there, and I do not know if ASIC has really provided the clarity and direction necessary for our members to know what they can and cannot do. Hopefully, this regime will make it much clearer.

Mr Reilly—The danger, if you follow through and say, 'What is the harm of licensing anyone who is required to give financial advice?'—and that would include someone who is recommending deposit-taking in a bank, because there is a degree of risk there in terms of interest rates and whether they are fixed or variable—is that you will then have to have a tiering of regimes for the type of expertise you require; for example, for someone who is giving advice on fixed versus variable home loans as against someone who is giving quite complex tax advice. That person may or may not be a tax agent, because the tax agent rules say that you are required to be registered only if you are actually signing or charging a fee for preparing the tax return, not if you are giving tax planning advice, as against someone who is advising on a typical sort of dealer's licence, proper authority holder—'Yes, buy BHP and sell out of

whatever else it is along the way.' So you are looking at quite complex licensing requirements that, again, our colleagues at ASIC would probably want to stay away from.

If within the current system of self-regulation that we have within the accounting bodies—and other bodies are able to produce similar arguments, I believe—then is that a better way to handle it, concentrating specifically on the securities area where there is a strong consumer protectionism and argument. The clients that Stuart has, for instance, are getting advice from an accountant on a day in, day out basis on how to run their business. That is really the dilemma, I guess, and I am not sure there is an easy answer to that one.

Senator COONEY—If, as you said, the main objective of an accountant is to add to the wealth of the client, that seems to mean that you are going to give advice about financial services and things like that, so the profession comes very squarely within what the bill wants to deal with. Lawyers, on the other hand, are trying to vindicate people's rights and adjust relationships between people, so their central purpose is not the creation of wealth in the same sense it is with an accountant. Then you could say, 'This is peripheral; they should not be bound by that because that is not their main function,' whereas with this it is. Therefore, since it is an accountant' s main function, they ought to be bound by the provisions of the act.

Just before you answer that, financial planners are going to say, 'We are developing an ethic and a code of practice. We can look after ourselves and therefore we should not be bound by it.' I do not know what the national insurance brokers say, but perhaps they might say the same sort of thing. So you get the wall crumbling. Can you help us through those dilemmas?

Mr Pragnell—In terms of our members, there has been a long tradition of self-regulation for accountants in Australia. I would argue that quite often regulators have chosen to rely upon us to assist them in the supervision of our members, primarily because they have recognised our ability to supervise and discipline our members. I would argue that that is recognised as well in the Financial Services Reform Bill—that both of our bodies have a very long tradition. We have worked with various regulators and have demonstrated our track record in being able to discipline our members. I agree that just because you establish a code of professional conduct and set up a disciplinary procedure it does not necessarily mean that you are a professional body and that you should be able to fully supervise your members without any regulatory intervention. But I think our bodies have both demonstrated a very long and serious commitment and have worked closely with ASIC, APRA, the tax office and other regulators and have demonstrated that over the years.

Ms Molyneux—That is not to say that the term 'declared professional body' does not, in fact, place onerous constraints on us and on our members. In the legislation, there is considerable responsibility placed on us. We would be comfortable with that. The problem is that we need to look at the particular area—the product-specific advice which needs to be targeted—where there is some system, repetition or continuity of product-specific advice, where a member might deal in financial products, take commissions or have financial product supplier-provider ties. That might be an area of focus for the legislation. From our own perspective, the declared professional body regime is not without onerous commitment on our part and on our members' part. To add to my colleague's comments, we have quality assurance programs, peer review programs, graduate entry and continuing professional licence requirements, all of which have

been established over a long period. We see that good financial advice is built upon that kind of quality program.

Mr Reilly—I have had discussions with the New Zealand Institute of Chartered Accountants because they have a number of members who are practising in Australia and providing business advice. Effectively, their question is: if you do have a declared professional body rather than simply a carve-out for professional accountants, how are those particular individuals covered? They would not be covered by CPA Australia or the Institute of Chartered Accountants in Australia because they are not our members, yet they may have been here for quite a period. I believe that one of the submissions was made by John Fielding, who is probably not unknown to you in other areas, particularly in the takeovers area. I think that John makes a very telling and quite lengthy argument, which is not surprising. He says that his business advice, basically, is to look at companies that are underperforming, to make investment decisions and to organise for groups to make those types of investment structures.

If you do head down the road of having a very broad licensing structure, which this legislation and certainly the earlier CLERP 6 legislation could be interpreted as doing, you also have to have some sort of provision for those types of people. That is why we have taken the view in our submission that we would support a narrowing of the licensing requirements—rather than having it be broad financial advice which sweeps up all sorts of people—to specifically narrow it down to the areas that, it is believed, do require regulation.

Senator COONEY—I was looking at 760A, which is the object of the chapter. It reads:

The main object of this Chapter is to promote:

(a) confident and informed decision making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services; and—

so it is pretty broad—

(b) fairness, honesty and professionalism by those who provide financial services: and

(c) fair, orderly and transparent markets for financial products; and

(d) the reduction of systemic risk and the provision of fair and effective services by clearing and settlement facilities.

CPA would certainly fulfil provision (b) concerning fairness, honestly and professionalism by those who provide financial services, but what about the others? To obtain (a), (c) and (d), shouldn't the provisions of this legislation cover accountants?

Mr Black—Licensing, by itself, is not necessarily going to solve or achieve that objective. Even under the current licensing requirements, you have got a lot of people who are proper authority holders but who are not qualified to advise on many of these products. They have got the brochures that they receive. They are basically relying upon the person's dealers licence to do it. It is not covering all of the other areas.

One thing about the accountants with regard to the CPA or the institute is that their very training, through the university and the courses that they have done, provides the qualifications they need to evaluate these products. The questions of integrity, honesty and all of that

transparency have been the ethics of the profession since day one. That is very telling as to why accountants stand out in that role. They actually fill those objectives very well.

Mr Reilly—Partially also in answer to your question, our members, in order to become proper authority holders, need to complete what is now a five-day course run by CPA Australia and by the Institute of Chartered Accountants in Australia. That enables them to meet the educational requirements that ASIC has in place to be proper authority holders. Others who are not professional accountants are required to meet quite a lot of detailed educational requirements. That recognises the fact that some of our members do want to specialise in the securities area. The difficulty in the past has been that, in order to become a proper authority holder to a dealer, the dealer also wants that particular person to spend quite a lot of time in that area. As Stuart said before, some of our members have said, 'If the legislation is just a little bit unclear, let us become a proper authority holder.' But it is very difficult to become a proper authority holder—not to meet the requirements but to get a dealer to take you on.

We have quite a lot of anecdotal evidence that suggests that a number of proper authority holders are being culled because they are not full time in that area or bringing the business through. Yet a number of them are there simply to make sure that they are meeting the occasional needs of their clients. Rule number one of our professional ethics is: do not go around doing work that you are not appropriately qualified to do. In our quality review program, that rule is looked at very carefully. Again, the evidence in the past has been that it has not been our members who have been involved in the Russell Island type schemes. We have been reasonably satisfied that we have been able to regulate that area.

CHAIRMAN—What is required for the next step up to become a dealer? Do they not need to be attached to anyone?

Mr Reilly—Educationally not a lot more, but there is quite a lot more in terms of the responsibilities that you take on board. You are also required to have financial solvency requirements in place. It is quite an expensive process.

Mr Black—We actually looked at getting a dealer's licence when we got some advice as to what we were doing, as many accountants have done. But given the cost of doing it and then passing it on for the benefit of others, and given the amount we were using it, to be honest we, like most accountants, chose to rely on the incidental advice and pushed it as far as we could. It is a stupid thing to have to say that we are doing that, but most people are. It is a catch-22 situation. A few people have now said, 'We would like to get licensed so that we can try to do it properly.' But, as the point was made, because they have not been doing it for the last few years they then say, 'We have not got experience.' The fact is that they have been doing it non-stop. It is a stupid world.

Mr Pragnell—Where most of our members get tripped up, if they want to acquire their own dealer's licence, is usually on the experience. ASIC will require anywhere between three and eight years experience, and generally that experience is not experience as an accountant providing broad financial advice but as a proper authority holder. Generally, that means that you would then have to affiliate usually with a large institutional provider, and a lot of our members are very hesitant about doing that. It would be very easy for them to go to an AMP or an organisation such as that and say, 'Give me a proper authority so I can start providing financial

planning advice.' Those organisations are aggressively marketing to our members to become their proper authorities because they know that our members are skilled, trained, trusted by the client and so on. The problem is that, if they enter into that arrangement, for a lot of our members—I am sorry if this is a North American expression—it becomes a bit of a 'lobster trap'. You enter into a commercial arrangement with the dealer group to get the experience and then it is very difficult for you to exit and get your own dealership because they own the client and they own the client data. Quite often the commercial arrangements are such that it is difficult to get out. You go in one end and you do not get out the other, and that is problematic for our members.

Mr Black—Also, it destroys your professional independence. The one thing that I and most accountants hold very high is that we provide independent advice. I have refused numerous times to be involved with any one particular provider because that locks me into giving non-independent advice.

Senator COONEY—I think that is a good point. I think it was the financial planners who said that they are charging fees. Who said that?

Mr Reilly—I think it was the Financial Planning Association.

Senator COONEY—Under the Migration Act—you might reckon I am wandering a bit and I probably am—it requires people giving advice under the migration law to be registered. They have a body set up to look at that and it catches some solicitors. Have you looked at how that works?

Mr Pragnell—I have a very crude understanding of it, but no, we have not looked at it closely.

Mr Reilly—We are asked as professional bodies to provide evidence as to the qualifications of accountants coming in from overseas, so from that perspective we have had some involvement in that area.

Senator COONEY—Are the disciplinary procedures of the CPA backed up by legislation? There is a statutory backing to the disciplinary proceedings that the medical profession or solicitors might take in any event.

Ms Molyneux—They are in our code of ethics, I believe, but not in a legislative frame, no.

Mr Reilly—What happens, though, is that our members who are involved in audit, for instance, are also subject to Corporations Law, and the Companies Auditors Liquidators Disciplinary Board can take action, so we have a close liaison with the regulator, with ASIC and also the Companies Auditors Liquidators Disciplinary Board, and again from a tax perspective there are provisions in place there as well. Our members value the membership reasonably highly. We have taken action in the past against members and excluded them from membership for non-compliance with our ethical requirements. That usually will have a flow-on effect if they then have other statutory registrations as such.

Senator COONEY—If I understand what you are saying, you are a professional body with a long and honourable professional history and you do not need regulations like this because in some sense it is a reflection on that, but, more importantly, it is not going to help the work you do do. I suppose the difficulty we face is on what basis can we excise the accountancy profession. I suppose it is almost a political question in the sense that, if you take the accountants out, what are the others going to say?

Mr Reilly—I guess we would reiterate what was in the Wallis inquiry. That was quite a detailed review. We would also argue that we have a requirement for professional indemnity in place. As Stuart referred to earlier on, there is some consumer benefit from that perspective, particularly in the traditional areas of accounting. At the end of the day I think we would also argue that you have to have a look at the evidences as to what injustice has occurred. That is why we come back to really the central thrust of our submission—that is to say, licensing has worked and has worked reasonably well in the traditional securities area of the financial product securities area. To broaden it out, to then pick up people who are giving advice on fixed versus floating rates of interest so you pick up all the bank staff to start off with and all those areas, means that you are then going to have a very complex licensing regime. That is really the danger—for what public benefit—ultimately. The benefit at the moment in the current Corporations Law and certainly under earlier versions of this was really to look more at the narrow securities area.

Senator COONEY—Who got the current scheme going in those bottom-of-the-harbour things that Frank Costigan looked at?

CHAIRMAN—That was the painters and dockers union.

Senator COONEY—Who thought it out? Who was the putty-nose who thought that up on his own?

Mr Reilly—It was before my time.

Senator COONEY—I suppose I am asking whether you have anybody in your organisation who has, for the last few years at least, acted very honourably. When I say you, I do not mean you personally, Mr Reilly, because that is a given, but members of the association. Can we go and say to the others that there is really no example of playing fast and loose?

Mr Reilly—If you are looking at things like bottom of the harbour schemes and tax advice, there is no requirement at the moment for you to be registered at all to give tax advice. Clearly, you are required to be a tax agent and to meet certain educational requirements and experience if you charge for providing advice for a tax return. The reality is that CPAs and chartered accountants will promote their services on the basis that they give professional tax advice, but there are others around who may not have that particular expertise.

Mr Pragnell—In terms of our disciplinary procedure at CPA Australia, I cannot speak on that because that is, in a sense, for some other staff in the organisation. We do have numerous staff who work full time only on issues such as quality assurance and discipline. We have full-time ethics officers in several of our state divisions and that is all they do—dealing with complaints regarding our members in terms of them breaching the code of professional conduct. Both CPA

Australia and the institute publish, on a monthly basis in our journal, details of disciplinary procedures regarding our members who have been dismissed, fined–

Mr Reilly—and otherwise dealt with.

CHAIRMAN—You never know: it might have been a lawyer rather than an accountant who gave the first advice on bottom of the harbour schemes.

Ms Molyneux—It may well have been.

Senator COONEY—But what the lawyers can say is that they are not into wealth creation, so this is not their main game. But you see what I am saying. I suppose we have to go back and say, 'This is a group of people who are traditionally honourable and are running a very proper organisation, and none of their members gets out of line much.' I suppose we can say that.

Mr Black—What you might be able to say—and I think it is the truth of the matter—is that if you go back traditionally accountants have always provided this advice. It was not until the seventies that a lot of other people started coming in and offering advice, a lot of whom were not accountants. In fact, we had a lot of people coming in from the insurance industry and from other areas with no qualifications as accountants trying to give financial advice. That is what actually precipitated this whole problem at the time—you had an influx of people with no qualifications.

CHAIRMAN—They were actually simply marketing financial products.

Mr Black—That is right. So the legislation has come in to stop that. But the legislation cut off the actual people who were originally giving the advice. So there is a history that they have always been there and that there has never been a problem from them.

Ms Molyneux—That is where it comes back to product specific advice for commission, which has largely been the problem. That tends to be the area on which the legislation perhaps needs to focus, not on the broader definition of financial advice, as my colleague has explained the unintended consequences that could well be put in place.

CHAIRMAN—Which by and large on the part of accountants would be on a fee for service basis, not a commission basis.

Mr Black—Nearly all accountants work on a fee for service basis. That gives you independence in that you are not picking the highest commission product.

Ms Molyneux—And you do not have that product provider tie.

Mr Black—It is very dangerous for independents to be tied to the product provider, because ultimately it removes the independence if there is an investment decision.

CHAIRMAN—So, in summary, what you are seeking is that the enabling provision in the bill for ASIC to make a professional body a declared professional body actually be more

explicit in relation to the accountancy profession and the black letter law rather than leaving it to ASIC?

Mr Reilly—We are doing a couple of things. We are saying that the legislation, in terms of financial advice, needs to be narrowed quite significantly, otherwise you will pick up the lawyers, because the lawyers are giving legal advice, which they are appropriately qualified to do, and are regulated by statute, which has a financial implication. I would not have thought the intent of the legislation would be to require most lawyers in practice—and quite a few who are operating in a commercial environment—to be licensed in fact. So we are arguing, firstly, that the licensing provisions need to be clarified and for it to be made quite clear exactly whom you want to be licensed. That is why we have spoken of traditional securities and giving financial product type of advice in the securities area. We have also supported declared professional bodies because we believe that can do two things. It can allow ASIC to regulate in specific market areas. If you are in the banking environment, for instance, and you decide that you want a degree of licensing there, then ASIC could regulate a declared professional body, being banks, to do that. Secondly, there is also the line that ASIC should not necessarily be solely out there actually providing licensing requirements and therefore you will enable other professional bodies that meet specific ASIC tests to do that.

It might well be that the accounting bodies, together or separately, decide to be involved in a number of different areas with ASIC and to be declared professional bodies. I would not want to leave you with the impression that we think that being declared professional bodies is the absolute answer to all of the questions. Otherwise, my colleagues from New Zealand, New Zealand chartered accountants and American CPAs, then have to fit into a particular area and you might end up licensing quite a lot of declared professional bodies internationally. So that is the dilemma.

Mr Pragnell—There is a potential to license basically 19 million Australians. In terms of the breadth of small employers, and so forth, there are very serious issues there, particularly if choice of funds does progress.

Senator COONEY—What about what I can call crumbling castle risk? What I mean by that is we are building the castle here to protect people who look to people for financial advice and follow that advice. This bill has erected a castle to protect them. Now we have had the banks come along and say, 'Look, we do not want a certain sort of advice to go into that.' And we do not want to be responsible for the advice people in the country give. You would know them, Mr Black; the pharmacists were the people who seemed to be quoted most. All they are doing is telling people about the different products we might have; they are not giving them advice about it. If we say that we accept that and we accept the accountants, don't other people come along and say, 'What about accepting me?' and so on. So, in the end, the castle crumbles. Should the CPA be, as it were, the Gandhi of the financial world and make the sacrifice even though it is a pure and honourable organisation? What would you say about that?

Mr Black—Could I suggest one thing. I think you also need to look at the difference between the product providers, the BTs, the AMPs, the MLCs of this world. There is obviously a very strong argument that they should be licensed because they are preparing the prospectuses, putting it all together and making the offering. But really, isn't there a dividing line between the people who then are independently assessing those products and advising on those? It seems to

me that, for public protection, you are almost better off to say that the people providing the product should be licensed—they are the requirements they have to meet. But then surely the people who are advising on those need to have the independence to be able to attack and say, 'That is good; that is bad.' As it works now, the people who provide the products control the people who recommend them. There is no provision—

Senator COONEY—So you say the test ought to be whether or not a particular person or organisation has an interest or can be seen to have an interest?

Mr Black—Yes, very much so. That is a good point.

Senator COONEY—And that the accountants clearly have not got an interest except to the client?

Mr Black—There interest is to their client only, not on selling the product.

Senator COONEY—You would say the only problem then would be competence, and that issue of competence is attended to by the CPA?

Mr Black—The qualifications of professional bodies.

Mr Reilly—That will be a market issue of the marketing at the end of the day. So you will have a chartered accountant or a CPA marketing themselves as against someone who does not have that qualification.

Mr Pragnell—You make the analogy of the crumbling castle. I think we would probably also make the analogy of not reinventing the wheel. If there are existing bodies who meet a certain standard in terms of their ability to guarantee or to ensure the professionalism and independence of their members and have the capacity to discipline those members, it would seem nonsensical for the regulator to overlay that with their own supervisory activities as well if they feel confident that they can rely on those professional bodies to follow through and use their existing procedures to ensure that we meet the objectives of the bill.

Senator COONEY—And leave the accountant like the umpire, whereas lots of the others are in the team. Mind you, the way these umpires are currently—

CHAIRMAN—Some of the umpires are in the team.

Mr Reilly—We might pass on that one.

Senator COONEY—I see; that is fair enough. I can follow that one.

CHAIRMAN—In your covering letter to the secretary of the committee, you say that you are somewhat perplexed by the parallel consultative processes at work—the submission to our committee and to the Treasury. You also question the usefulness of this inquiry as we may also choose to investigate any future bills.

Mr Reilly—What we were trying to say there is that the legislation in draft form was released without a great deal of consultation beforehand. In early February, we had a three-month timetable to provide submissions, and three months disappears very quickly. We were therefore a little surprised when the committee said it was going to look at it within a two-month frame. We were trying to buy a little bit of time by saying, 'By the end of two months, rather than three months, we will have formed our initial views. However, in that further month, we will also be gathering further advice and evidence from our members.' And then we were saying, 'Perhaps the wording wasn't as clear as it should have been. We would also like the opportunity, once we have the government's and Treasury's staff response to the initial bill, to be able to come back to the committee and say, "In April, we said it was fine but we now find the bill has changed its form and we think the minister was moving on a very tight timetable."' We were very gently suggesting that perhaps the parliamentary committee might want to then look back at just what the government did on the initial bill. I think that was all we were trying to say.

Mr Pragnell—We did not want to forestall the opportunity of parliament to review a bill which is actually different from the exposure draft.

CHAIRMAN—That is certainly not our intent. In fact, if I can take you back right though the CLERP process, it has always been that we look at the draft bill, make recommendations on that and then look at the final bill as well. We do not regard that as duplication because, as parliamentarians, we take the view that we did not get rid of the divine right of kings to create the divine right of bureaucrats and the parliament. It is efficacious for the parliament to have an input into the draft bill consideration process. In a sense, it may be more effective in getting changes at that stage rather than at the final bill stage. We will certainly be looking at both the draft and the final bill.

Mr Pragnell—I agree with that.

Senator COONEY—You are right: it does take a long time, if you are a good association, to get around your members, to get the stuff defined, to work out an approach and then articulate it.

Mr Reilly—We have also had—this is now the third part of the puzzle, I guess—an initial discussion paper, which went back a number of years, then the CLERP 6 paper came through and then the Financial Services Reform Bill paper came through. We have had a lot of involvement with our members, but there have been some fairly significant changes in each of those papers. This current one is of that sort of thickness. We almost need a few weeks to go through and read it. You have had the same challenge.

CHAIRMAN—Thanks very much for your appearance before the committee and for your very detailed input today. It has been very useful.

MACLEAN, Mr Alan, Financial Services Committee, Law Institute of Victoria and Law Council of Australia

CHAIRMAN—The committee has before it the Law Institute's submission, which we have numbered submission No. 37. Do you wish to make an opening statement in relation to that submission?

Mr Maclean—Yes, if that is possible.

CHAIRMAN—You are welcome to do that, and then we will proceed to questions.

Mr Maclean—The fundamental issue which we need to address is whether members of the legal profession should be regulated by the proposed CLERP 6 legislation. From the outset, as set out in the Law Institute's submission, we believe that members of the profession who are engaged in the provision of financial services or of financial advice and do not provide traditional legal services should in fact be regulated by the legislation. For instance, those who profess to act as financial planners, or counsellors, or who promote investment schemes should in fact be caught by the legislation.

We say that those who provide more traditional legal services, such as the provision of legal advice in relation to a contract, should not be regulated by this legislation. The very broad definition of financial product advice, as you have probably heard during the course of today, does present some problems, and it brings into the scope of the legislation those such as accountants and lawyers who perhaps should not be regulated.

The more difficult situation is for those in the situation where a person in the legal profession provides legal advice as well as financial advice. For instance, you may in fact act on behalf of a client in relation to a conveyance, and the client might ask you for advice in relation to how the conveyance proceeds should be invested. That is a bit of a hybrid situation: should or shouldn't that be regulated under the legislation? We would say that that is just incidental to providing a legal service and, as such, should not be regulated.

Senator COONEY—Say that a client sells a house, the funds go into a trust account and the client then says, 'How should I invest the funds?' If the solicitor says, 'Why don't you put them into a mortgage?' that would be a standard thing to say. But if the solicitor says, 'You might try shares in the red terra goldmines,' that would create a bit of a problem, wouldn't it?

Mr Maclean—I guess the dividing line is that a lawyer does owe a fiduciary duty to his or her client. As you have heard from previous submissions from the accountants, to the extent that the advice is provided in that capacity and that duty is owed, in those circumstances, we would say that, no, the lawyer should not be regulated by this piece of legislation. To the extent that the lawyer is not receiving a benefit or some form of commission from the issue of the financial product, he is acting independently and does owe that duty to the client. As such, it probably already falls within the exemption currently contained in section 775 of the Corporations Law as being advice that is given as part of or incidental to the business of acting as part of the legal profession. It is also consistent with the current ASIC Policy Statement 119 which I believe in that situation would mean that the solicitor for that side would be required to hold an investment advisers licence.

Senator COONEY—There have been some spectacular instances where solicitors have taken funds and wasted them. The guarantee fund is under all sorts of strain. Maybe you ought to have a provision in here that if a person is licensed as a financial adviser and he or she commits a crime that the fund should not have to pick that up.

Mr Maclean—There are currently state based regulations in place to deal with disciplinary matters, to deal with assurance and indemnity funds, to the extent that a client does suffer a loss as a result of the acts of a lawyer.

Senator COONEY—Why should the profession generally have to pay for one of its members who creates a loss not through acting as a lawyer but through acting as a financial dealer?

Mr Maclean—If they are not acting in a traditional capacity as a lawyer and they are providing financial services then certainly they should be regulated by this legislation. But to the extent that they are simply interpreting contracts providing traditional legal advice, the existing exemption which applies in relation to investment licences should continue to be maintained.

Senator COONEY—How would that work? Say a lawyer is just giving advice about a contract, how would the issue even arise? He would say, 'This is what that contract means. These are the terms and this is what it means.'

Mr Maclean—Given the very broad definition of financial product advice, it is likely that that advice or opinion or interpretation of the contract is likely to influence that person as to whether they acquire a particular financial product. For instance, if a lawyer is giving advice in relation to a derivative contract, or in relation to superannuation products, there is a real risk given the breadth of this definition that financial product advice is being given.

Senator COONEY—Can you take me through that? That sounds quite alarming. You need not take me through it now, but I would be interested in—

Mr Maclean—If you look at the definition of financial product advice, it says it means 'a recommendation, a statement of opinion or an interpretation of information, or a report of any of those things.'

Senator COONEY—I have lost the section now.

Mr Maclean—It is section 766B of the bill.

CHAIRMAN—It is reproduced in the submission.

Senator COONEY—It seems to me that that is aimed specifically at advice in terms of trying to influence somebody to invest in a particular way where somebody has approached them for that advice rather than an opinion.

Mr Maclean—What we would say is that there needs to be some clarification included in the legislation. In fact, the Law Council of Australia in their submission said that if an exemption under section 775 is not to be maintained then there should be a carve-out from this definition of financial product advice to carve out legal advice.

Senator COONEY—Are you saying that if you got an opinion from counsel that the counsel could be caught by this?

Mr Maclean—Do you mean from a QC?

Senator COONEY—From anybody, whether he or she was a QC or not.

Mr Maclean—Yes. Even if the intent of the definition is not to catch that type of opinion, it is certainly quite conceivable that advice given in relation to a contract could influence a person's decision whether to acquire that particular product or not.

Senator COONEY—So if the Treasurer went back to his old profession he might get caught?

Mr Maclean—That is a possibility, yes. The way that we were hoping that it could be addressed is through either the maintenance of existing exemption or, alternatively, a carve-out from the definition of 'financial product advice' to specifically cover legal advice.

Senator COONEY—What you are saying is that, if the person is acting as a lawyer in the traditional way, that person should not be caught by this; but, if he or she goes beyond that and dips the toe in the water, they should.

Mr Maclean—And there have been fairly notorious instances where lawyers have gone beyond their traditional role and have promoted investment schemes under which there has been considerable loss. What we would say is that this legislation should regulate those people.

CHAIRMAN—I think you were part-way through your presentation when you were interrupted by some questions.

Mr Maclean—There are a number of other reasons why we would suggest that the exemption or the carve-out from the definition should continue to apply. I have mentioned in part that it would create a dual regulatory system, both state and federal, and we would say that the current state legislative system adequately supervises the conduct of lawyers. We would also say that the current policy for the exemption, in section 775, should be continued—namely that, where a lawyer provides financial advice as an integral and nearly incidental part of providing legal services, that should be exempt from the legislation. I suppose the other point that has been made is that this legislation is very much designed to regulate central participants in the financial services industry. It should not be designed to regulate those who are on the periphery of the financial services industry and who have some influence upon whether financial products are acquired or not.

Senator COONEY—They are not in the circle at all except in terms of giving advice.

Mr Maclean—Obviously, if a solicitor became an agent for a financial services licensee, they would have to be an authorised representative. There is a separate regime in the legislation to deal with that. The other aspect is that, if lawyers were regulated and they gave general financial product advice, they would have to give a warning statement to their clients saying that they had not taken into account the financial objectives or needs of the client. In fact, that is exactly what

the client does expect from their lawyer when they obtain legal advice. It is only a very minor point, I know, but I thought I would mention it nevertheless.

As I mentioned before, if it is decided that the current exemption does not continue, we would say that there needs to be a carve-out from the definition of 'financial product advice'. We put up a definition of 'legal advice'. I can read that out to you. It is in the Law Council submission, which you do not have before you. In the Law Council submission it was suggested that 'legal advice' should mean:

> ... advice on matters of law, legal interpretation or the application of any law to factual circumstances, given by a legal practitioner practising in the course of his or her profession, including without limitation, a recommendation, a statement of opinion, or an interpretation of information forming part of or incidental to such advice.

There are a number of other issues which have been raised in the Law Institute's submission, and we have in fact taken those up independently with Treasury officials. We are hoping that, as part of the redraft of the legislation, some of those more technical drafting issues will be taken care of. We can only wait until we see the next draft of the legislation to deal with that.

One matter in particular that concerned us was the question of a party dealing in a financial product. A party deals in a financial product if they actually induce an application to be made. It is arguable that a solicitor, for instance, in a country practice may in fact induce his or her client to actually apply for a financial product simply by having brochures or something of that nature in their waiting room. What we were trying to ensure was that that aspect of inducing had some positive active persuasion on the part of the particular person concerned, that it just did not simply involve some sort of passive or unintentional act on the part of the person which would then bring that person within the confines of dealing in a financial product. So that was another aspect of the submission which we did mention to the Treasury officials and we are hoping that they will take cognisance of that in the redraft.

The other aspect which concerned us was the timing of the legislation, particularly bearing in mind that applications will have to be made for licences, assuming an exemption is not granted. Secondly, applications will have to be made by professional bodies to ASIC to be declared professional bodies so that they can in fact obtain exemptions for their members. Given that there are approximately 33,000 solicitors and barristers in Australia, some of which are represented and others that may not be, that in itself will be quite a large task for ASIC to perform and will require some time. What we are saying is that the legislation should in fact be delayed until 1 July next year at least and appropriate transitional arrangements put in place so that these applications can in fact be processed.

CHAIRMAN—Thank you for your presentation. On page 5 of your submission you say:

> A lawyer may deal in a financial product if the lawyer induces or attempts to induce a client to apply for or acquire a financial product other than by means of providing financial product advice.

Can you perhaps enlarge on the circumstances where that would occur or what the procedure would be where they are not actually providing advice but they are inducing investment?

Mr Maclean—The example I gave you, for instance, where the solicitor in a country town has brochures from a number of financial institutions sitting in his or her waiting room and their clients in fact pick those up and are influenced to acquire that particular product. Is that lawyer attempting to induce in that situation? There may be situations where the lawyer does not in fact give advice but they are still seen to be inducing. I suppose it is very difficult, given that—

Senator COONEY—The difficulty you are going to have is that if you have a conversation with a client and the client then says, 'Mr Maclean has given me this advice,' which is just simply an interpretation of what you have said, you are explaining the situation to him or her, but he or she then takes it as advice and it puts you in some sort of difficulty. The fact that he or she might be wrong does not help you.

Mr Maclean—I suppose it is always possible that you can give advice which does not fall within the definition of financial product advice, but which nevertheless does induce the client to obtain the financial product.

Senator COONEY—The interpretation is put on it by the client.

What you would say is, 'Unless it is quite clear that I am giving financial advice as a financial adviser, I should not be caught up by this.'

CHAIRMAN—I have heard about this, although I am not personally familiar with it, but the so-called solicitors' money or solicitors' funds which I understand are basically where solicitors in effect act as mortgage brokers, do you think that is appropriate to be caught up by this legislation or should that role of solicitors be excised?

Mr Maclean—I suppose you would ask yourself the question: what is the financial product? It is certainly an investment and therefore, as such, probably would fall within the definition of financial product. I believe that type of activity should be regulated to the extent that the solicitor is, in fact, promoting a form of investment to his or her client. Other members of the law institute and the Law Council may take a contrary view to my own view and believe that that type of mortgage practice is already well regulated by state legislation and various indemnity funds and, as such, should not be regulated by the CLERP 6 legislation.

There are varying degrees of safeguards that have been introduced by various state legislation throughout Australia. Some legislation is probably more up to date and provides greater safeguards for consumers than the legislation in some other jurisdictions. It is always a question with state based legislation in trying to strike some consistency and uniformity, which this legislation would possibly do.

CHAIRMAN—Where you talk about the arrangement between the lawyer and the client where the lawyer causes his or her bank to make non-cash payments, I assume you are talking about distribution of cheques or some electronic transfer of funds. It is still a financial transaction—

Mr Maclean—Again, it is a very technical argument based upon the definition of a 'non-cash payment facility.' I have taken this up with Treasury, and it stems from the use of the words 'or cause payment to be made'. Those words are very broad. Theoretically, if a solicitor asks a banker to make a payment, the solicitor is causing a payment to be made on behalf of his or her client. That is where we saw some difficulty, and we understand that Treasury are looking at that to see if they can strike the appropriate balance.

CHAIRMAN—You would say that you are really just acting as an administrator of the fund.

Mr Maclean—Yes, that is right. You are just the middleman.

CHAIRMAN—You are not dealing or advising.

Mr Maclean—That whole area of non-cash payment facilities is a bit of a minefield in itself, given the breadth of the phrase.

Senator COONEY—If a solicitor said to a client, 'You're being sued. We'll take a series of legal proceedings to ensure that the matter doesn't come on as quickly as it might otherwise and thus hold the plaintiff out of his or her money,' would that be financial advice?

Mr Maclean—I would not have thought it was advice given in connection with a financial product.

Senator COONEY—What about a dispute between two companies over shares and who should go forward with a takeover?

Mr Maclean—But it is not intended to influence a person to acquire a particular financial product in that situation.

Senator COONEY—But it is certainly a tactic that may have an effect on securities.

Mr Maclean—I suppose that is always possible. That type of information may well have a bearing upon the price in the market and, as such, may have some implications for other provisions of the Corporations Law. But I cannot quite see how it would have any direct relevance to the definition of financial product advice.

Senator COONEY—Let us say that somebody sues in terms of shares or some other security and a solicitor says, 'This person is suing for this. We'll just outspend him in the legal resources we throw at this.' That affects the fate, at least, of shares. What would you say about that? That is advice having an effect upon securities, even though it is indirect.

Mr Maclean—I do not think it is intended to influence the client to acquire those particular securities in that situation, is it?

Senator COONEY—It does not have to. It is intended to influence a person in making a decision in relation to a particular financial product, not a client. So the person that you are suing or who is suing your client might well make a decision. He might say, 'I'm going to abandon my attacker'.

Mr Maclean—The advice is not given to that person. It is given to your client. I am talking about the lawyer here.

Senator COONEY—So no financial product advice means a recommendation, a statement of opinion, an interpretation of information or a report of any of those things that is intended to influence a person. It does not talk about your client.

Mr Maclean—I guess you need to read the definition in the context of the wider provisions in the bill which talk about financial product advice being given and then the disclosure requirements that are required if that advice is given. So a product disclosure statement has to be given, a financial services guide, et cetera, if a recommendation is given as part of that advice.

Senator COONEY—One of the objects of this chapter (c) is fair, orderly and transparent markets for financial products and (d) the reduction of systematic risk and the provision of fair and effective services by clearing and settlement facilities. If somebody takes legal proceedings that are going to impinge in some way on the fairness, honesty and professionalism of those who provide financial services or impinges upon the fair, orderly and transparent market for financial products, isn't that within the scope? If you take action or defend an action that is aimed at influencing a person in respect of his or her approach to security, that sort of thing is done often enough.

Mr Maclean—I do not believe there is any substantive provision in this legislation in the CLERP 6 bill itself which specifically deals with the scenario you have in mind.

Senator COONEY—I think what you are saying is this only refers to the clients of those giving advice but that is not how 766B(i) reads.

Mr Maclean—As I say, you need to read that definition in light of the substantive provisions where—

Senator COONEY—That is what I was trying to do by quoting 760A.

Mr Maclean—For instance, where financial product advice is given and a recommendation is given as part of that financial product advice and the recommendation is given to a person, in those circumstances, you are obliged to provide a product disclosure statement in relation to the financial product.

CHAIRMAN—It is the consequence of being a financial adviser. What you are saying is, does giving the sort of advice in that court case make the lawyer a financial adviser and, if that is the case, what is required is they have got to give a disclosure document and all that? This would not be relevant to the case you are talking about.

Senator COONEY—You would be doing it for a client. You would have to give your own client some sort of knowledge. It does not talk about clients; it talks about a person.

Mr Maclean—But the person who is providing the advice is giving it to a person. It is directed specifically to that person. But, in the scenario you have just suggested, I do not think it is directed to the other company whose shares are being acquired.

Senator COONEY—Does it have to be?

Mr Maclean—I would have thought there needs to be that direct nexus.

Senator COONEY—Can you look at the legislation.

Mr Maclean—I have not got the legislation in front of me but I can certainly go through it with you later.

CHAIRMAN—I think the issue then is, if it does catch, what is the consequence? The consequence is he has got to give a disclosure document, and so on, which, in the scenario that you are painting, is not relevant because the issue is the suing and countersuing, isn't it? So it would not be relevant.

Senator COONEY—Except in that you then advise your client to say, 'We're going to take this action to affect the shares that you are interested in.'

CHAIRMAN—But that is not governed by this legislation, is it?

Senator COONEY—It might be.

CHAIRMAN—But what is the consequence then?

Senator COONEY—The consequence is that, if you say to your client, 'We can help you here by influencing this other person's decision about the shares that you want,' then you would have to give a statement to your client. It might be even fair to give it to the other side so that when they go to court they have it all set out.

Mr Maclean—But as I said, advice has to influence your client, not the other person, because you are giving the advice to—

Senator COONEY—No, it has to influence a person, not your client.

Mr Maclean—But the advice has to be directed to somebody.

Senator COONEY—That is right.

CHAIRMAN—The advice you are giving is not directed to the other person; it is directed to your person.

Senator COONEY—But the legislation does not say that.

CHAIRMAN—I think you are trying to put even more complexity in there than is there, Barney. We have enough to deal with as it is.

Senator COONEY—The legislation says:

(1) For the purposes of this Chapter, financial product advice means a recommendation, a statement of opinion or an interpretation of information, or a report of any of those things, that:

(a) is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products...

Certainly if you take action to influence another person other than your client, that other person is still a person.

CHAIRMAN—On that note we will conclude. Thank you very much for your evidence to the committee and for your answers to our questions. That concludes our hearing.

Committee adjourned at 6.06 p.m.