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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Friday, 27 April 2001

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

Senators and members in attendance: Senators Chapman, Conroy, Cooney and Gibson

Terms of reference for the inquiry:

Financial Services Reform Bill 2001.

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Committee met at 10.58 a.m.

FARRELL, Ms L. KATHLEEN, Chairman, Corporations Law Committee, Law Council of Australia

HOYLE, Mr Michael, Member, Corporations Law Committee, Law Council of Australia

CHAIRMAN—Welcome. Today the committee conducts its first public hearing into the provisions of the Financial Services Reform Bill 2001. The Parliamentary Joint Statutory Committee on Corporations and Securities decided to inquire into and report on the provisions of the Financial Services Reform Bill 2001, which was introduced into the Commonwealth parliament on Thursday, 5 April this year. The committee sought submissions by 20 April. However the committee desires that as many people as possible have an opportunity to comment on the bill; consequently the committee has resolved to receive submissions up until Monday 7 May. For the same reason the committee has also resolved to hold further public hearings on this bill subject to what further submissions might be received.

At a previous meeting this morning the committee agreed to release all submissions received on this inquiry. Submissions will be available from the parliament house web site or alternatively the secretariat can send a hard copy of the submissions to those who wish to obtain them. Before we commence taking evidence I wish to reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to evidence provided. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for the discharge of parliamentary functions without obstruction and fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before the Senate or any of its committees is treated as a breach of privilege. I also wish to state that unless the committee should decide otherwise this is a public hearing and as such all members of the public are welcome to attend.

I firstly welcome Ms Kathleen Farrell and Mr Michael Hoyle who are representing the Law Council of Australia. Do you have an opening statement you wish to make? If so you may proceed and then we will move to questions from the committee.

Mr Hoyle—Thank you. We have made a written submission in relation to the amendments proposed in the FSR Bill to require the tape-recording of telephone conversations during takeover bids. We have made a number of points in the written submission and we are happy to answer questions in relation to those but there are three key points I would just like to stress at the outset.

The first is that in our view the policy case for this proposal has not been made out. The proposal represents a significant change to takeover regulation in Australia. It will impose significant costs on bidders and targets, it will limit their freedom of action, and in many cases we believe it will prove difficult to comply with. Accordingly, it should only proceed if there is a demonstrated need. In our view there has been no evidence of abuses that require this remedy.

Secondly, if there is a view in some quarters that there is a need for this measure, we believe that view should be exposed for discussion. Both this government and its predecessors have

consulted widely in relation to corporate law reform, and we believe that has improved the quality of legislation in this area. We are firmly of a view that a proposal such as this should only proceed after proper consultation.

Thirdly, if a decision were made to proceed with a reform in this area we believe that it would need a significant redrafting. The draft provisions seem to us to largely miss their mark and run the risk of hitting some innocent bystanders. We believe that they would need to be redrafted if they were to serve the purpose that is intended. So our view in a nutshell is that this measure should not proceed at this time as part of the FSR Bill process but should only proceed after proper consultation.

CHAIRMAN—Thank you. Was this tape-recording proposal part of the draft exposure bill that this committee dealt with before?

Mr Hoyle—No.

CHAIRMAN—Because I certainly was not aware of it being part of that draft.

Mr Hoyle—So far as we are aware it has never been mentioned until this bill was introduced into parliament.

Senator CONROY—Have you had a chance to have consultation with Treasury, for instance, to get a sort of explanation as to where and why—what the abuses are that they are seeking to cover?

Ms Farrell—Given the shortness of the timeframe for submissions and I think also given that we do think it is profoundly bad in policy, we thought it was important to get the submission to this committee first. It is unusual for us not to have had discussions with Treasury about this and in the ordinary course we would—and we apologise to Treasury for not doing that. This is I think profoundly bad policy. Largely, tape-recording of conversations is only permitted, certainly where governments are involved, where you are concerned about a crime that is going to send you to jail for seven years—treason, kidnapping, murder, things of that order. The Corporations Law only puts someone into jail for a maximum of five years, and this proposal produces some very unusual distortions. It concentrates on the bidder and the target and on conversations initiated by the bidder and the target.

If I as the bidder put an advertisement in the *Sydney Morning Herald* that says, ‘If you want to talk about the bid ring 1800 whatever’, then it is unregulated by this. There is a whole area of consumers with whom you can have conversations that are regulated today by ordinary fair trading, laws of obligation not to be misleading and deceptive, which we think are appropriate. We think that is okay and we think with the increasing shareholder base that Australia has that it is appropriate that people be able to have those conversations.

So, in identifying the gap we are not suggesting that you fill it; we think that people should be allowed to do that. The practical effect of that gap is that the conversations that are constrained are those with the big investors and international investors, so the bidder and the target cannot ring up the AMP and say, ‘Our reasons for doing this are X. What are your concerns? Is this in the right sort of price range for you to feel comfortable.’ All of those are important

conversations for the efficiency of the market. You will chill those conversations incredibly badly if you require them to be recorded. I think that in weighing the balance of an efficient market and proper enforcement of takeovers laws a proposal such as this one really does not fall into the balance particularly appropriately.

Mr Hoyle—Yes, I think to pick up on that point, it is not just that you chill those conversations but there will be enormous practical difficulties in complying with them. People are travelling extensively during a takeover proposal, think of the recent Shell-Woodside takeover. If every time someone from Woodside had to talk to someone from Shell and they had to tape-record it, how would they do it? If they are talking to potential counterbidders who may hold shares in Woodside and they have to tape-record those, how would they do it? Then, as Kathy says, it seems that the communications with the retail shareholders may well not be caught, not only for the reasons of not catching calls initiated by shareholders but typically I think companies engage outside consultants who are usually independent contractors, and it may well be that those sorts of mass retail communications are not caught.

I have just this morning quickly noted that there were two submissions to this committee by two companies which engage in this business, and those submissions list in them the campaigns they have conducted, and they express the view which I think is shared by us that it does not seem to be an area where there have been complaints by ASIC or anyone else about the way in which these campaigns arise. There may have been occasional instances but there has certainly not been any general sense that this is a serious area of concern on more than occasional instances.

Senator CONROY—You are not familiar with any complaints that have arisen in any of the takeover bids? I have never had anyone call me and say, ‘Look, this is either just an odd one off or a systemic issue.’

Mr Hoyle—Given the short time period we have not done an extensive consultation even within our own committee but certainly the people who have been involved in this submission are not aware of this being an area of concern.

Senator CONROY—Could I certainly on my behalf apologise for the short timeframe. I think certainly the committee has been very conscious of the short timeframe and we have I think indicated by press release, which did get picked up in the *Financial Review,* that we have extended the deadline for submissions. So if there are other issues or further evidence that you feel comes to light so that you would like to put in at least a supplementary written submission rather than necessarily appearing again, we would certainly welcome your further informed views in this area on an aspect of the bill. We are very conscious of the timeframe and I think the possibilities of meeting the currently expressed timeframe by the minister are highly unlikely simply because of the committee’s workload.

Ms Farrell—Someone will have complained somewhere along the track. It would be beyond human experience that someone might have complained about something— whether or not it was a valid complaint is a completely different issue. But Freehills does a lot of takeovers, Macquarie Bank does a lot of takeovers. We are not aware of an endemic problem in this area.

I must say in relation to call centres that the other thing to be aware of is that every time in any large transaction that I have been involved in the call centre has been used. The script that each of the call centre operators is to use is very, very carefully vetted and each time it goes to be amended it is normally done in consultation with the lawyers. Now, will one individual call centre operator get something wrong? Possibly, but again what is the balance that you are seeking to achieve here? Having 30,000 shareholders having someone to ring who has been scripted in relation to the story which ASIC can get under its notice provisions—it can certainly get access to the scripts—

Senator CONROY—This is a regular process. I have actually talked with call centres that are involved, and we vet them.

Ms Farrell—That is right. I think the heart of this problem is not one which calls for such an intrusive response as this.

Mr Hoyle—And it is also relevant to note that we are talking about a situation where both the bidder and the target have an obligation to send out a written document that sets out everything material to the shareholders in any sort of contested campaigns, and they do try to make at least the front portion of that something that is reasonably intelligible to the retail market. To the extent that there has been some press commentary about concerns, I think the only ones I have seen were saying there were some concerns in relation to the AMP-GIO takeover. There is litigation which is ensuing from that but it relate to the written documents.

Senator CONROY—I am sure some people are particularly sensitive about GIO, given their role in scamming people by selling it in the first place.

Senator COONEY—Has the Law Council conferred within its own body with people expert in criminal law and in privacy and things like that?

Ms Farrell—No, we have not but clearly the privacy concern is a big one. I used to be a prosecutor—or was for a couple of years anyway—and certainly having a piece of evidence like that is useful from a prosecution viewpoint but if you are dealing with call centre operations where you can be getting hours and hours and hours and hours of tape over a period of weeks or months, actually finding it is sometimes hard and query whether or not finding the particular thing that you are looking for is sometimes harder, but I know they are talking about an index here that will let you go to a particular conversation, but if you are not looking for complaint driven investigation, if you are looking for ASIC to find it, it is never going to happen. It is not a useful deployment of ASIC's resources.

Senator COONEY—Did you ever recommend as a prosecutor that somebody's phone be tapped?

Ms Farrell—None of the offences that are available under the Corporations Law activate the wire tapping provisions.

Senator COONEY—What I was getting at there though is that if you did use wire tapping, wire tapping has that quality of going on and on and on for hours and hours and hours, and yet prosecutors cope with it.

Ms Farrell—I am aware that in investigations by other bodies where the punishment that was called for enabled the activation of tape recording one of the issues is how long you have got to spend with it, but there we are talking about treason, kidnapping, murder. We are talking about as serious an offence as you can be talking about.

Senator COONEY—I understand that. What I am talking about though is that I thought what you were saying is that this is impractical because you have got to tape such lengthy conversations, series of conversations, but what I was really asking you was, 'Well, don't people do that? Don't investigators do that already?'

Ms Farrell—They do, but they tend to not be on the scale that would be called for in a takeover.

Mr Hoyle—Just looking at one of the submissions by one of the communications companies here, they say they run a 230-seat call centre. If you have got 230 people going all the time—and that leaves aside the communications we say that you would not be able to have because you would not have the facilities to tape-record them but would go on directly between the company and its shareholders in this situation, you actually prevent many conversations that ought to take place and then you would have huge numbers of conversations that would be of a routine sort.

Senator CONROY—I appreciate you refer to it in the most damning of terms when you describe the proposal as novel and radical. From my conversations with some of those call centres I actually do think some of them have tape-recording provisions overseas and some of them actually do, so I am not sure that it is quite as novel and radical but I am sure that due to the shortness of time when you were trying to pull this together you may not have had a chance to research it extensively.

Mr Hoyle—That has been a constraint. I am certainly not aware of it being the case as a takeover regulation device. If there is something else which regulates call centres, it is possible we may have missed that but certainly we monitor international takeover regulation and—

Senator CONROY—Do you have any concerns—and I am not quite sure whether the legislation quite goes so I would be interested in your interpretation—in terms of disclosing to the person receiving the phone call that a tape-recording is being made? Normally practice under the law requires you have to disclose. I presume that would be the case.

Mr Hoyle—Yes, there is a provision requiring that.

Senator CONROY—And concerns that people may not be willing to participate in a phone call where they are being taped?

Ms Farrell—Often people will not.

Senator CONROY—Yes, and I certainly am on a couple of boards and we have telephone hook-ups, and I object to the taping of the telephone hook-ups, but certainly that would seem to me to be a potential outcome if you introduced this legislation.

Ms Farrell—I made the point before but I think it is worth reiterating. You have practical difficulties with the consumer end of things, simply because there are so many, and the practical difficulty is getting to the bit that you want and just creating and storing that amount of information on the off chance that a regulator might actually want to look at it. It does not contain the normal exceptions that you find dealing with professional investors, and by that I mean the people who do not even have to get a prospectus to invest in a company. Their conversations here would also have to be recorded, and I think they are people who can well and truly look after themselves in the to and fro of any negotiations, so I do not think that that is an area that is appropriately regulated.

Senator COONEY—Should you decide criminal law on the basis of whether people can look after themselves or not, so that you say to somebody, 'This is not great because you should have been able to look after yourself?'

Ms Farrell—If you are talking about criminal law that are offences against the person, no. If you are talking about the Corporations Law, which in essence an economic law, some areas of which actually do not even deal with morality but regulation, then I think it is open to you to decide that there are some people who for the proper and efficient regulation of the market, the balance is that they do not require protection, and frankly most of them do not want it.

Senator COONEY—Are you saying that the vice this legislation is aimed at is not very prevalent and therefore the parliament should not introduce it, or that even if it is prevalent the remedy is useless—or is it a bit of both?

Mr Hoyle—I think both. We are certainly saying that we do not believe that there is evidence of a serious abuse. All that is said in the explanatory memorandum is that it would allow people to investigate whether statements that are made are misleading or deceptive, and I think as we also say in the submission there is a general prohibition in trade and commerce Australia not to engage in misleading or deceptive conduct, so one could equally propose that every oral communication in trade and commerce in Australia should be tape-recorded to allow people to investigate subsequently whether it is misleading or deceptive.

We suggest you should only contemplate this sort of monitoring as well as the prohibition of misleading or deceptive conduct if you feel that there is a real need to investigate things after the fact, and we do not think that need is demonstrated. If you could demonstrate it, it is possible that there may be a remedy of this sort that should be considered but we do not think this is the right one, and certainly the need is not demonstrated.

Senator CONROY—Could I seek your indulgence. I appreciate that due to the short timeframe you perhaps have not covered all of the issues that you may have liked to in your submission, and can I again invite you, if there are other issues in the bill that you would like to make a submission on, to either come and visit us again or put in a supplementary submission. Can I ask you about declared professional bodies?

Ms Farrell—You can ask me about declared professional bodies. Would you like to deal with that?

Senator CONROY—We will shortly hear from some of your Victorian colleagues. With regard to what you understand is incidental advice: can you give us some examples?

Mr Hoyle—I have to say it is not an issue that I have really considered and I work for investment banks, so we are more the other way around.

Senator CONROY—What financial advice do your members provide?

Mr Hoyle—Do members of professional bodies provide?

Senator CONROY—The legal one. I am specifically interested in your profession.

Mr Hoyle—I do not think as a committee we have examined this and I would not like to express personal views based on my own experiences, because I have had few.

Ms Farrell—Not speaking for the Law Council, because I have not discussed this with the Law Council, I primarily deal with corporations. I deal with them in the takeovers and prospectus area. I tell them what the law is. I often tell them whether or not I think a particular course of action is a good or bad idea based on my experience over very many years of dealing with this sort of thing.

At one level you might consider whether this a good or bad idea advice, investment advice, and if you were going to put that as loosely, regard that really loosely, then it is. I do not think I am doing my job as a lawyer and an experienced expert in this area unless I can give them the advice that says, 'If you do this the consequences will be X. You should think about that. Do you really want to do that?' That is what commercial legal advice is about. One of the things lawyers get criticised for is quoting back to people the sections of acts, and if that is all you do then I do not think you have earned your hire. I also do not think you should be regulated by securities legislation in relation to, and based on, that experience in these contexts; you should think about whether or not you should do X or Y.

Senator CONROY—So no advice you give is incidental then in your view?

Ms Farrell—It is all incidental. The primary purpose of someone coming to me is not whether or not they should make an investment or whether or not they should make a takeover or whatever, but there are incidents to the legal advice that I give them that have a sufficiently commercial aspect that if you tried to regulate all securities advice on one argument it would fall within it and it should not—particularly in the context of things like takeovers where there is almost always, not always but almost always, an investment bank involved who is licensed to give that sort of advice.

Senator CONROY—I appreciate you have not had a chance to look through all of it and that this is more a personal view than that of any organisation. Are you concerned by the absence of an incidental advice exemption in the FSR Bill?

Ms Farrell—I really have not considered this. I am happy to consider it and to submit back to you about it but I think that is probably the more appropriate course for us to take.

Senator COONEY—I would certainly like to hear from you again after you have looked at it. I understand what you are saying about your advice as a lawyer. Does there ever become a point where you say, ‘ I am not going to advise you any further? ‘, given your approach in this?

Ms Farrell—I at a personal level always refuse to advise anyone about numbers and those areas that are absolutely outside my area of expertise.

Senator COONEY—As long as they are in your area you are happy to give anybody advice about whatever they want to hear?

Ms Farrell—As a matter of fact my practice is self-limiting and I deal with grown-ups. By that I mean very large corporations who have experts within them and are capable of evaluating the advice. At a more consumer level I do not know about the answer to that.

Senator COONEY—So, no matter what the big corporations want to do, if they want your advice you will give it to them?

Ms Farrell—On?

Senator COONEY—On any matter that is pertinent to their problem as they see it?

Mr Hoyle—They may wish to draw on your experience. If someone comes to you to say they are considering investing in what might appear to be a tax driven agricultural investment scheme and they may want legal advice on it, you may give them legal advice. Then you may say, based on your experience of these sorts of deals, whether you think it is a good or bad idea for them to do it. I can see that saying to do it or not do it based on your experience might be more than giving legal advice but may be something people would value from a lawyer.

Senator COONEY—What I was getting at—and I would just like your opinion on this—is that you are saying, ‘Look, this legislation is draconian in effect because it deals with a matter in a very harsh way and that matter does not really loom large in the scene, but even if it did it would be very onerous to have to keep all this recording.’ I am just wondering whether there is any element in the system that is based on an ethical approach to things, and it was in that context that I was asking whether there is anything that the lawyers would not do—because if there is not then we might have to think about bringing in legislation to remedy a problem, even if it is a minor problem in terms of this occurrence.

Ms Farrell—I can ask you a question back. What is so special about securities? I go into David Jones and I want to spend $500 on a dress and the person behind the counter says to me ‘You look fabulous in it’. The truth is that I do not. I am going to spend $500 doing it. The person who is selling it to me has certainly behaved in a misleading and deceptive fashion and I do not look fabulous in it, but no one is suggesting that the activities that go on in the ladies dressing room at David Jones should be tape-recorded because someone in trade and commerce may be unduly gilding the lily.

The truth is that when you are dealing with securities there is a law that says you have an obligation not to be misleading and deceptive but the primary communications actually are written. You get a bit of statement, you get a target statement. A lot of communication is by way of

advertisement or letter. The primary areas that fall outside that are things like call centres on the one hand and the commercial negotiations that go on with very large investment houses that are really important conversations about expectations, in particular on price but, last but not least, these days the financial press performs a very large role in evaluating takeovers and prospectuses and all sorts of things that are around. There are a wide range of sources from which consumers get information. They are not just the call centre that they ring.

One of the concerns that I have in this sort of legislation is that you are taking the responsibility away from the investors to inform themselves about the investment that they are making and if I had a policy imperative to run it would be to encourage the much wider Australian investment community to get themselves better educated and to be more aware about the investment that they have on a regular basis.

Senator COONEY—Since you have asked the question—which is fair enough, and a lot of people from this side of the table say we are here to ask the questions not to answer them— I have to answer it. The difference between you going to buy a $500 dress and people who are going to make investments in securities are as follows in my sort of very limited experience. First, when you are investing in securities you are likely to be putting a lot of money into it; it might be your life savings. If you get into a dispute as an ordinary person on the street and you want to do something about it, you want to go to court, the other side have probably got lawyers of your expertise charging very heavy fees and likely to be charging those fees not only to have the matter litigated but to see that the matter is extended in court to the point where the person on the other side cannot in any way get a remedy from the court, cannot afford it and cannot afford it because he or she is up against very wealthy opponents and employing very wealthy lawyers who, as I say and I keep saying this, just keep extending the case until the person drops off the end. That is the first point, and that happens.

Secondly, if they are big corporations and look after themselves you are likely to have deals done where people who may be, say, in superannuation funds and what have you, have got people who are in control of their money doing deals over which they have got no control, even though the result of those deals might be that they have lost their money. In other words, what if you have got no process by which an ordinary person—and what I mean by an ordinary person, people who live comfortably with a nice house, a nice car, sending their children to private school—still can survive in this area unless there is some protection for them? That is what I am saying. I could keep going but I will not.

Mr Hoyle—I do not think we are disputing that there is a need for regulation of this area; we are talking about a narrow area of takeovers. We are not talking about people managing investments and I do not think requiring tape-recording of conversations makes any difference to some of the practical difficulties of enforcement subsequently, although it does seem that there is increasingly class action in this area by people who are doing it on a different basis. This does seem to be opening up more remedies for shareholders.

Ms Farrell—It will not be a single tape-recorded conversation that does that. It will be a defect in the takeover document that gives a whole class action. The other thing—and you have raised the points about superannuation funds and the like—is that every time you ask a company to engage in expense that is not expense directed at its business and systematic recording of conversations in the context of takeovers, and indeed a whole range of other places, that is

adding cost to the structure of that business and that is directly taking away people's pension funds at the end of the day. You have to ask yourself, 'Is the tape-recording of one conversation out of 30,000 that happens to have been bad worth the systematic cost in 10 takeovers where that did not happen but all of those companies spent all of that money in the balance the right thing to do?' Generally, I do not think it is, particularly where, as in this proposal, there are real privacy concerns that come up as well. Tape-recording is a very draconian response.

Senator COONEY—The cost of any regulation is an impost on business. That is really an argument to say, 'Let's not have a police force, that we abolish the police force.'

Ms Farrell—But it is a balance. I am not saying at all that you do not regulate. I believe that you do regulate and that one of the reasons why we pay our taxes is so that you have appropriate infrastructure and the cost of some regulation is appropriate infrastructure. Each time that you go to seek to impose a regulation, particularly an intrusive one, I think you should ask the question, 'What is the balance in this case?'

CHAIRMAN—Can I just go back to this issue of incidental advice. As I understand the legislation it provides that the professional body—in the case of lawyers it would be the Law Institute— will be effectively registered and thereby all the profession will be exempt from individual registration licensing where the advice was incidental. Is that how you understand it firstly, and is that a satisfactory way of dealing with the issue?

Mr Hoyle—That is how I understand it and I understand that there is a concern. I understand that there is an exception for lawyers through that arrangement but that it only currently covers the provision of legal advice, and I suppose the question is whether that is broad enough if lawyers in the course of giving legal advice touch on anything that pertains to the commercial merits of an investment; is that within or outside the exemptions proposed. I can see that quite often lawyers would feel called on to give some incidental commercial advice. If their primary role is to give legal advice, they also give advice that is not just, 'What is the legal effect of this arrangement?' but 'Is it a sound or not sound arrangement based on the lawyer's experience of advising on these things.' So I can see there is a benefit in having an incidental advice exception. Again, that is a personal view.

CHAIRMAN—You do not believe that is covered at the moment by the professional body being—

Mr Hoyle—I have not looked at it closely but I do not believe that it is covered in the current draft bill, no.

Ms Farrell—As I said, on the Law Council's behalf I am happy to look at it and respond to you again but I understand that you are actually going to talk to the Law Institute and a couple of other people too.

Senator CONROY—We might be suffering from a shortage of time to delve in and get legal advice on these sorts of things. I just have a follow up question—and apologies for my lack of understanding how the Law Council works. You have got state divisions?

Ms Farrell—The Law Council is a national body but it works with each of the state law societies that actually assist in its funding.

Senator CONROY—Do you oversee them in anyway? Do you oversee them? Is it they are just independents and you are the national structure?

Mr Hoyle—I think the constituent bodies regard their role as overseeing the Law Council.

Ms Farrell—They do.

CHAIRMAN—How is the Law Institute different from the Law Society?

Mr Hoyle—It is the Law Institute in Victoria and a Law Society in New South Wales.

CHAIRMAN—It is the same, just a different name.

Senator CONROY—You would be aware there is some concern and in fact ongoing ASIC investigations into some practices of some of the law councils around the country. Are you familiar with those at all?

Ms Farrell—No. The law societies?

Senator CONROY—The management of mortgage broking?

Mr Hoyle—The law institutes and law societies have the role as regulators. It is state based, so they are the regulators of lawyers in each state and the law council is a representative body that deals with policy issues but has no regulator function. Yes, I am aware of there being issues in relation to mortgage broking but it is not something—

Senator CONROY—Do you think it is good policy to run mortgage broking schemes, for state councils to do that?

Ms Farrell—Could I have the entertainment question? I think that is inappropriate for—

Senator CONROY—You have got no view about the many, many hundreds of millions of dollars that seem to have gone missing under the management of your state affiliates?

Ms Farrell—Put it this way: I think that when you are making policy decisions you distinguish between where people are broking an investment, which is what is happening with mortgage investment schemes—

Senator CONROY—Is it incidental advice, do you think?

Ms Farrell—And incidental advice, which is commercially ‘What would you do in this situation?’ You will not have good professional lawyers and accountants and people like that if they are not free to say, ‘In the circumstances I would do X’, and the community will pay a very

high cost if you sought to regulate that. I think there is a different decision set about things like mortgage investment schemes, and perhaps different criteria apply to that.

Senator CONROY—That is the question I am really trying to get to. I can accept an incidental advice argument but I have some difficulty saying that just because you are the law council or the law institute of any state you are qualified to run a mortgage broker scheme and claim exemption under the basis that you are a lawyer.

Mr Hoyle—I think that you have raised what is clearly a legitimate question, and my understanding is that there have been legal practices in various states that have functioned perhaps more as mortgage brokerage schemes than legal practices, but there are also lawyers who do, as I say, give legal advice and some commercial advice. I think one ought to be allowed and perhaps the other might need to be regulated, and there is a definitional problem—

Senator CONROY—That is what I am trying to get to, because at the moment if your body is given an exemption from training on financial aspects of the financial advice they give then one of these people who have been running these mortgage brokers would be exempt, and do you think that is a fair position? You just said that maybe there is a different regulation. I am inviting you to expand.

Ms Farrell—I think we are here with the Law Council hat on. I have not even spoken with the Law Council about what their views are on this. It is difficult to answer the question in this context. I think you are better off getting those submissions in a more formal way from other people.

Mr Hoyle—The questions are not incidental to what we are here for.

Senator CONROY—I am reluctant to let you off the hook.

Senator COONEY—Just following on from what Senator Conroy was saying, when you say you are not giving advice, a lot of the contracts that seem to be around these days are as thick as the Corporations Law volumes. A lot of those seem to contain policy and they will contain all sorts of statements that really are quite vague—that this will be done according to commercial quality. It is almost like a novel. Are those not contracts themselves really giving them advice, public advice?

Ms Farrell—They often are but often it is legal advice. The commercial aspects of them often actually do not come from a lawyer at all but, for instance, when a lawyer drafts an advice or gives advice about advice that a broker is giving, the broker is in fact giving the securities advice and the lawyer is giving advice about how the law applies to that. True it is that you give your best legal advice when you understand the industry that your client is in and the things that motivate that industry, what its strengths and weaknesses and opportunities and threats and everything else that go to it are, and I think parliament should encourage lawyers and others to be as aware in that regard as they can and not seek to put impediments in place of that, because otherwise you get formalistic advice that actually does not help anyone very much.

Senator COONEY—A lot of it comes straight off the word processor, doesn't it? Some of these volumes of contracts?

Ms Farrell—Unfortunately, increasing quantities of it, but the only people sometimes who do read it are the lawyers and they have to.

Senator COONEY—That seems to me to just be a practice perpetuating what in effect is advice forever almost. Should that not be regulated?

Ms Farrell—No. It is already. If I do not read what I give a client then I have probably been negligent, I am available to be sued and, if I keep doing it, I am going to lose my practising certificate, so I am regulated in practice.

Senator COONEY—To read every contract it would take you hours and hours and hours.

Ms Farrell—I do read every contract.

Senator COONEY—What is the cost of that?

Ms Farrell—I have to read every contract that I am giving advice on otherwise I cannot give the advice.

Senator COONEY—But is there any move in the Law Council to bring those contracts into some sort of balance so that they are readable, so that the ability for people to sue for negligence is reduced because the chances are fewer? What is the Law Council doing about that? If they are not doing anything why should they not be regulated under this particular—

Ms Farrell—I do not know that the Law Council has a simplification program per se. I think there is a large commercial pressure and I think the commercial pressure is the right place for it to be—coming from clients to have readable documents.

Senator COONEY—So the Law Council, as far as you know, is content to let these voluminous contracts continue?

Ms Farrell—The Law Council is only content about that on the basis that people are giving professional advice about the contracts. People often use the phrase 'all you do is a press a button on a word processor'. That gives you your precedent. It is the place you start; it is not the place you end.

Senator COONEY—An argument can be run here that there is a lot of, if not policy, at least the direct consequences of policy in those contracts and why should lawyers not be included in the provisions of this legislation to ensure that we know what they are doing and what sort of discussions have taken place prior to the—

Ms Farrell—Because they already are regulated about that. That is part of the heart of the practice and, if you are not doing it, it is negligent.

Senator COONEY—Yes, but that is a negligence claim and if you are taking a negligence claim against a lawyer that is again money that you have got to spend that you have not got.

Mr Hoyle—There are different regulations that apply to lawyers and people who are engaged in the financial services industry. One of the issues is that this legislation introduces new product disclosure requirements and things of that sort. If someone goes to the lawyer to ask them, 'What is the legal effect of making this investment and would you give me some legal advice about it', you do not expect your lawyer to give you a financial services guide or a product disclosure statement, or all these other things—

Senator CONROY—And a mortgage scheme for you.

Mr Hoyle—I think it is not the issue of whether you are regulated or not, or whether you are liable for negligence; it is when do you get into these extract disclosure requirements that are supposed to be applying to people who are giving the financial advice? As we have said before but really do not want to keep going further into is that lawyers do give something which is incidental and—

Senator COONEY—For a lawyer to write a contract other than one that comes from the word processor, the lawyer has got to give financial advice, got to say what is the effect of legislation, what is the effect of the law on this particular financial transaction and the financial transaction is going to result in a particular outcome. He has got to give financial advice; he cannot do anything else.

Ms Farrell—One of the great benefits of having a modern commercial society, which is something that we should prize and not seek to constrain unduly, is that there are necessary areas of overlap in all of the professions and in other areas of commercial endeavour. The right question is: what is your primary job? If your primary job is giving legal advice then I think there are appropriate sets of regulations largely already in place. If your primary job is giving financial advice then there are a different set of imperatives. On large scale things often you need both people to give the appropriate advice but each of them will at some level overlap. So Macquarie Bank, when it is advising on a takeover, will say 'I think you have a legal issue there', and the answer might be X, but they are not giving legal advice when they are doing it; they are saying, 'Go talk to somebody whose primary job is that.'

I think that you are creating an undue pyramid of regulation if what you do is say that in relation to the incidental areas of overlap that you have to comply with everything that conceivable can touch on it. If you do that no-one will do their day jobs and they will do the bits that are around the side badly.

Senator CONROY—You would agree with the following submission:

Nevertheless, the provisions of the FSRB are considered to be an unwarranted intrusion into the independence of the legal profession. To require solicitors to limit advice according to the conditions imposed by ASIC will severely limit the independence of the profession and impede the provision of independent, impartial advice to clients.

Ms Farrell—Depending on what the question was, that might be the right answer.

Senator COONEY—What you are objecting to is the oppression of this legislation?

Ms Farrell—Which legislation are we talking about? We came to make a submission about tape-recordings. That is the only thing we are actually objecting to at the moment.

Senator COONEY—That is the legislation you are talking about, and you are saying this is an oppressive sort of thing to do, to make people tape. Yet an argument could be run that that is the only real protection for a small investor, a small person who has got financial issues to decide, to get some protection against an overwhelming force of very big companies, very wealthy companies that are capable of using money to run him out of the courts—they just keep it going. It would surely gives him or her some protection against these extraordinarily complex and heavy contracts. That is very oppressive for the small person: why should he or she not have some protection by way of tape-recordings these discussions?

Mr Hoyle—I think two things. First, tape recording makes absolutely no difference to the proceedings. As Kathy said earlier, if you talk about a remedy for that it generally lies in class actions which will generally lie in people having a common cause of complaint, which will come from a document rather than an individual telephone conversation. As I said earlier, in this area of takeovers we have seen there is class action on foot in relation to the AMP-GIO takeover, there is a class of a huge number of shareholders, there is a law firm that is quite prepared to run that class action for them. They are running it against AMP. There is not much sign of it being held back because there is an inability to pursue the claim and they are pursuing it based on the existing requirement to have a document that says everything, and they are saying it was misleading. I do not know what the outcome of the litigation is, but people are able to pursue remedies in this area. I do not think this proposal will actually help them in any way. It will have many, very bad effects that are incidental and I do not think it will achieve much.

CHAIRMAN—As there are no further questions, I thank both of you for appearing before the committee and the evidence that you have given us this morning.

[11.49 a.m.]

PARKER, Mr Robert John, Member, Financial Services Committee, Law Institute of Victoria

CHAIRMAN—Welcome. I assume Ian Dunn and Greg Tucker are not appearing?

Mr Parker—Yes, my apologies to the committee; we have had a couple of scratchings today. Unfortunately Mr Dunn is in hospital, I believe, so I have not had a chance to finalise submissions but we have a draft and I will address the committee on the basis of that.

CHAIRMAN—We have before us your submission which we have numbered 7. Do you wish to make an opening statement?

Mr Parker—Yes, if I may.

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

Mr Parker—To a large extent we have covered a lot of the issues with the Law Council representatives. The Law Institute has made previous submissions to this committee in July 2000, in particular on the issue of the extent to which legal advice or incidental advice is subject to the licensing provisions. I note the committee made recommendations to the government to exempt legal and incidental advice given by lawyers in the course of their professional practices. The second issue is the provisions relating to declared professional bodies. The Law Institute submission is restricted to those two points.

On the issue of incidental advice, the bill provides an exemption for advice given to a lawyer in their professional capacity about matters of law, legal interpretation or the application of law. There are three specific heads there. It is our submission that is a narrow interpretation and that it should be extended to include incidental advice on the basis that lawyers commonly give incidental commercial advice in the course of their practice and are expected to do so by their clients. It is also our submission that the scope of that incidental advice can be fairly narrowly scoped based upon existing concepts of what is within the scope of a solicitor's normal practice and what is outside it.

There are a number of cases in the context of professional indemnity insurance claims, for instance, where it is quite clear that the court has drawn a line where a solicitor has gone outside the scope of their normal professional activities and dealt on their own account or otherwise given financial advice. Those things are outside the scope of a lawyer's normal professional activities and we are not suggesting that those should not be subject to the normal licensing provisions. What we are suggesting is that incidental advice where the primary objective of the client retaining a lawyer so as to obtain legal advice should be outside the scope of the licensing provisions.

The second issue is in relation to the proposed division 7 and the regulation of declared professional bodies. We make the observation that most of the substantive detail is left to the regulations and/or ASIC determination. At this stage the institute, if it is intended that it become

a declared professional body, would have to seriously consider that option as to whether it undertook the liabilities that were attracted by becoming a declared professional body or not. At this stage we can only speculate as to what the content might be. If the requirements are substantive, then it could result in the legal profession effectively becoming subject to ASIC's regulation on top of the existing regulation by the various state governments. I do not know whether the committee would like me to elaborate on any of that?

CHAIRMAN—Thank you, Mr Parker. To clarify – and correct me if I am wrong – what I am understanding you to say is that, if a legal practitioner who is a member of the professional body that becomes a declared professional body gives advice in relation to financial matters, this declaration still only covers legal advice. It does not exempt them from being registered separately in relation to financial advice if the advice is, in effect, incidental.

Mr Parker—As I indicated with the second point, whether the institute or the Victorian RPA becomes a declared professional body is something that would need to be determined in the future.

CHAIRMAN—For the sake of my question, assume they become a declared professional body. Does that mean that the advice they give is covered if it includes an element of financial advice, or does it only cover legal advice? Because I would have thought legal advice was exempted from the provisions of this legislation anyway.

Mr Parker—That would ultimately depend upon the conditions imposed by ASIC under division 7 and we do not know what they—

Senator CONROY—We do not want to suck it and see either.

CHAIRMAN—It is dependant on those provisions rather than on the provisions of the legislation.

Mr Parker—Yes.

CHAIRMAN—We are in the hands of the regulators, not the hands of the legislation.

Mr Parker—Yes, totally. As I said, that is assuming that the body becomes a declared professional body. In the absence of that, if the institute or the Victorian RPA, which regulates the profession in Victoria, or the law societies in other jurisdictions elect not to become declared professional bodies, then lawyers will be restricted to giving purely legal advice and not any incidental commercial advice.

CHAIRMAN—That is not the understanding we were given by the minister. We were given the understanding by the minister that this introduction of the idea of a declared professional body would deal with the concerns about incidental advice. But you are saying that is still subject to whatever the regulations are.

Mr Parker—We do not know.

CHAIRMAN—It is not determined by the legislation, you are saying.

Mr Parker—No, it is certainly not in the legislation.

Senator CONROY—I am sure you heard me say our apologies earlier for the short notice and time period to study the issue and, importantly, consult with your members as well as put in a substantive submission. Can I apologise on my behalf and, I suspect, the committee's behalf on the timeframe for you. You mentioned a definition of incidental advice that is commonly understood; I am not aware of that.

Mr Parker—There is a concept of what is incidental to professional practice, and it has arisen in the context of, for instance, professional indemnity insurance that covers the practice of a solicitor. There are certainly cases where, for instance, solicitors deal on their own account in financial products, and that has been determined to be outside the scope of their PI polices.

Senator CONROY— Are there any cases either the Law Institute has had to deal with or that have been through the courts?

Mr Parker—I can cite cases and when the submission is finalised, I will include those in it. Would you like me to cite them now?

Senator CONROY— No, if you are putting in the supplementary submission, that will be—

Mr Parker—There will be a submission that is finalised which will include those details.

CHAIRMAN—Apart from the issue of incidental advice, what are the other issues in relation to division 7 that you believe are regulation rather than legislation?

Mr Parker—Precisely. As to the legal content of division 7 we have no problems, but the point is the substantive requirements are not contained in division 7; they are to be included in regulations and ultimately a lot of the regulation will be left at ASIC's discretion. So we are at the mercy of the regulators to determine what the requirements will be later and, indeed, to change those at any later time.

CHAIRMAN—But apart from this issue of incidental advice, what other issues arise from that?

Mr Parker—From division 7?

CHAIRMAN—Yes, that concern you.

Mr Parker—There are a number of things that could be specified in the conditions that are imposed by ASIC. There is a reference in the legislation to provide training.

Senator CONROY— Does ASIC determine training standards?

Mr Parker—ASIC will ultimately have to determine training standards and it would be our submission that if training standards are to be imposed on lawyers in relation to the operation of their professional practice, then those should be imposed under the state regulatory regime rather than by ASIC under the Corporations Law.

CHAIRMAN—Anything else?

Mr Parker—As I said, it is quite a short and pithy submission.

Senator CONROY— ASIC put in a submission to the draft bill which talked about a definition of incidental advice. Could I quickly run through it to get your reaction to it, whether you think it is too restrictive or it is fine or it is not restrictive enough? The three factors they talk about which are indicative of whether advice is incidental are: that the investment advice the lawyer or accountant gives forms an integral and merely incidental part of their overall services; they charge no discrete fee for the advice; and they do not receive any commissions or other benefits from product issuers. Does that seem fair and reasonable?

Mr Parker—Certainly that reflects existing policy statement. The second and third points we have no dispute with. The first point, in general, yes, I would agree with it, although I make the observation that sometimes the advice, whilst it is not the primary advice that is given, might be a significant part of the advice.

CHAIRMAN—If that was incorporated into the legislation rather than being left to regulation and possibly therefore varied, you would be happy with that if that was then covered by the declared professional body.

Mr Parker—Yes.

Senator CONROY— Do you see a need for both an exemption for incidental advice and a process for declaring a professional body exempt?

Mr Parker—It is our submission there should be an exemption for incidental advice, apart from the process of having declared professional bodies.

Senator CONROY— If you are covering off all the bits you really think need to be covered off and it was a comprehensive definition to your satisfaction, do you still think there is a need for the exemption?

Mr Parker—I would submit that there is. Sorry, I will reframe the argument. The need for declared professional bodies is only attracted if a licence would otherwise be required. Providing legal advice, including incidental legal advice, should simply be outside the scope of the licensing regime.

Senator CONROY— What would they be left to get exempted from if you have got the exemption for incidental advice? What else are you lot up to?

Mr Parker—There may be some areas of practice, for instance, the mortgage practices which are some—

Senator CONROY— We are going to get to them, as I am sure you can guess. You would not possibly be advocating they should be exempted, would you?

Mr Parker—No, certainly not. What I am advocating is that where there are significant financial services provided, such as by a mortgage practitioner, then that should be subject to division 7. But where it is purely legal advice and advice that is incidental to that legal advice, it should be outside the scope of the licensing regime.

Senator CONROY— That is what I am trying to understand. If you have got your incidental advice exemption for the whole profession, what is the purpose of the further declared professional bodies carve out? I am trying to understand; you have captured everything in a definition. Let's say we move an amendment successfully in the Senate, and maybe there will be a few different words, but you were satisfied this covers you off on all the areas you truly believe are appropriate, what would be the point, then, in keeping a declared professional exemption for lawyers?

Mr Parker—There may indeed be no purpose in keeping that. Alternatively, there may be some areas of the profession—as I said, the solicitors' mortgage practices—that could be subject to division 7.

Senator CONROY— The declared professional body process only limits the financial advice given by lawyers to that which they are competent to give.

Mr Parker—Yes.

Senator CONROY— I am going to the end of the Western world in your paragraph that I quoted before to your colleagues which says that requiring solicitors to limit advice according to the conditions imposed by ASIC will severely limit the independence of the profession. How is limiting the financial advice given by lawyers that they are competent to give intruding on legal independence?

Mr Parker—The intrusion upon legal independence is more through the process of declared professional bodies being subject to regulation under division 7.

Senator CONROY— Easy, we just do not have one for you.

Mr Parker—Sorry?

Senator CONROY— We do not have a declared professional body carve out and there is no intervention in your independence.

Mr Parker—If the carve out is appropriate, then there is no impediment to the independence of the profession.

Senator CONROY— What financial advice or services do your members currently provide to their clients?

Mr Parker—There are numerous circumstances where commercial advice is given to people and perhaps I could give an example. If a small business man, a person who is in business on their own account, comes to me and asks me about incorporation, I can tell them the legal results of incorporation, the fact that there is limited liability, there is perpetual succession. That is all pure legal advice. I might also indicate to them that they will need to seek further rollover of their current financial arrangements with the bank, they might be required to give personal guarantees, they might be required to give mortgage over their own personal properties. I might also indicate to them that they consider taking out key man insurance; if they are the major person that runs the business, that they should consider taking out PI insurance.

A lot of that is not pure legal advice. For instance, if I recommend that they take out key man insurance, I would advise them to go and consult an appropriate licensee and get an appropriate policy, and I might review the policy and give them some legal advice on the policy. As the bill is drafted at the moment, purely advising them that they should go out and key man insurance could be seen to be financial advice.

Senator CONROY— Do you think that holding a law degree qualifies your members to give extensive financial advice?

Mr Parker—Certainly not. Holding a law degree qualifies a person to give legal advice but the alternative is to restrict the profession to giving purely legal advice and no other advice. In the example I have just given, I would be in a position where I would have to say, ‘These are the legal results of incorporation. I have to tell you to go and see a financial adviser about financing the business or taking out appropriate insurance,’ and tell them to go and see a financial planner down the road.

Senator CONROY— Just extending your example, an individual comes in and says, ‘Look, I am unsure as to whether to set myself up as an incorporation or a partnership.’ Are you giving them legal or financial advice?

Mr Parker—I would suggest it is a combination of both. It is legal advice to the extent that the legal consequences of incorporation are different to running the business as a partnership.

Senator CONROY— They have asked you a financial question, haven’t they? It is not a legal question they are asking you.

Mr Parker—It is a combination of financial and legal. There may be different taxation consequences and, to the extent that I give them advice on that, it is a legal question. There may be commercial consequences and, to the extent that I give them advice on that, it is not a legal matter. The point is the issues are inextricably intertwined. As a professional, I cannot give a person part of the answer.

Senator CONROY— Why do you think your members are qualified now to be able to give the best financial advice, and you are accepting that there is some part financial advice here? I see a quantitative difference between you saying, ‘Look, it is a good idea to take out

insurance,'—and I am not a lawyer—and you advising that it is in their better interests, not from a legal perspective, to set up as a partnership rather than incorporate. That is a financial decision, what is in their best financial interests. There may be some legal ramifications on which I accept you would be absolutely derelict not to say to them, 'No, you will disadvantage yourself legally if you go down that path or that path.' There is a large degree of financial advice that they are seeking, and you are not really the appropriate person for them to be seeking it from, I would have thought.

Mr Parker—I am not suggesting I pull off a key man insurance policy from the shelf and suggest to them, 'Here, this is the appropriate policy.'

Senator CONROY— No, absolutely.

Mr Parker—What I am suggesting is that it is appropriate, and it is expected of lawyers, that they give commercial advice, not just the legal part of the transaction but you look at the whole transaction that is in question and give the client a full picture. To the extent that they then seek out key man insurance, they will go to a licensed financial adviser and get the appropriate policy. It is not my role to advise them on the particular policy but I do not see that I should –

Senator CONROY— If you tell them that they need it, you do not think it crosses the line? Regarding the financial implications, you may just be interchanging these words because in your mind they mean the same so I just want to make sure I understand whether you think these two words are the same or not – commercial and financial advice. Are you interchanging or is the habit that you use the word 'commercial'? Nowadays, in the new jargon we use 'financial'. Is there a differentiation in your mind?

Mr Parker—I admit I have been using them interchangeably. There is some difference: commercial advice probably includes some degree of financial advice and some degree of other business advice.

Senator CONROY— So you do see them as different concepts, because what we are arguing about is the definition of some words here as well about financial service or not. I am trying to see whether you see your role in giving commercial advice as necessarily slightly separate, and whether there is a way to draw a line between what you see as your commercial advice as opposed to a financial advice. I do not know if it is possible; it may be entirely impossible.

Mr Parker—I see financial advice as a subset of commercial advice, but I am not sure that you could draw a clear distinction.

Senator CONROY— But you accept that holding a law degree does not qualify you necessarily to give financial advice?

Mr Parker—Most certainly not.

Senator CONROY— If your members wanted to be giving financial advice, you would accept the need for some degree of training qualification?

Mr Parker—Certainly if lawyers are giving financial advice that is critical to clients, then they should get the appropriate qualifications and gain a licence; in fact, many of them do so. The point that I am making is that in the example that I just gave, to the extent that I am making a recommendation that they should consider particular types of financial product rather than specific financial products and then referring them to the appropriate licensed adviser to pick the specific product, then it should probably be outside the licensing regime.

Senator CONROY— If that financial provider happened to work for the same legal company, that would be a related party transaction or not?

Mr Parker—I had not considered that. A solicitor that was referring clients to a related licensee—

Senator CONROY— I can understand it if you referred him to the association; there is a no strings attached. But if there is a law firm that incorporates many types of commercial advice and you said, 'By the way, Bob down the corner does those things, wander off,' do you think that is crossing the line between giving independent advice and a related party transaction, to use a simple phrase?

Mr Parker—The current distinction that ASIC draws in the policy statement, where if the lawyer has a financial interest in it or receives some sort of kickback or commission, is appropriate.

Senator CONROY— You think that would apply to the firm, if you like, or an associated firm entity?

Mr Parker—Yes.

Senator CONROY— That even though you personally did not get the kickback, your firm did.

Mr Parker—Directly or indirectly concerned or financially benefited by the transaction, then I accept that that should not be considered to be part of the incidental professional advice.

Senator CONROY— I will not hold you accountable for what your sister organisations in other states have got up to. What is the status of the Victorian Law Institute Council's mortgage broking schemes? Are they currently also under investigation by ASIC? I know that Western Australia has just called a royal commission into their scandal and Tasmania has certainly got some very serious questions to address itself to. Has the same problem been prevalent in Victoria?

Mr Parker—I am not qualified to answer that.

Senator CONROY— You would not want to give me financial advice even if it is incidental to the inquiry?

Mr Parker—I am just not qualified to speak on behalf of the institute to the extent to which the mortgage practice schemes may be under investigation.

Senator CONROY— Do you think the mortgage practice schemes should be licensed? Do you believe they have been incidental to the—

Mr Parker—I am not putting forward the point that the mortgage practice schemes are incidental to legal practice. They should either be subject to the general licensing regime or perhaps subject to division 7, if that is appropriate, but certainly not within the scope of providing legal advice or incidental legal advice. I am not sure that that has ever been suggested that running a mortgage practice is part and parcel of the legal practice.

Senator CONROY— You mentioned that many lawyers have got financial training.

Mr Parker—Yes.

Senator CONROY— Do you think a blanket carve out for the association is the appropriate thing for your association to seek or would you only seek an exemption for those who had received some extra financial training?

Mr Parker—I do not see that it should be limited to those people who have had financial training. As I have suggested, if it is considered that the profession as a whole should be subject to some mandatory training requirements—and I believe there are in New South Wales—then it is up to the respective state regulatory authorities to impose those.

Senator CONROY— There seems to be a gap here but I am trying to get to an understanding of where you are coming from. You are accepting there is incidental advice and it covers this much. There are some lawyers who have received financial training and they would certainly fall into any category of having a licence check already. If you had acceptance, then ASIC will accept theirs. But there has got to be a bulk of work and lawyers that are somewhere in between incidental advice and qualified. I asked you before whether or not you thought just having a law degree qualified you to give financial advice and you said no. So I am trying to understand how you see the people that are in between incidental advice and those who are trained, whether or not you think they should be entitled to an exemption from a licence if they are giving financial advice.

Mr Parker—There may be scope for specialisation and if a practitioner is appropriately specialised, it might be they are granted a conditional licence to practise in that area of specialisation, such as taxation advice, but not outside that.

Senator CONROY— You would rather let everybody run free than try to find a way to license a small proportion in that circumstance?

Mr Parker—Most certainly that is not what I am suggesting. What I am suggesting is that what is purely incidental at one end of the scale should not be licensed; what is clearly giving financial advice at the other end of the scale should be licensed.

Senator CONROY— I am trying to find where you are drawing the line, because initially there seems to be no gap between where incidental advice ended and financial advice has ended. But you seem, during the discussion, to have opened up a bit of a gap, and I am concerned that probably the vast bulk of your members fall into what is now a wider gap than where—I know Hansard cannot record what my hands are doing—it was. Can you help me try to clarify where that line is between the people with a licence currently and would automatically get a tick and those that do not but you would see maybe have some special experience rather than necessarily qualification. I accept that experience is a valid argument. If you have been doing it for 20 years and you are keeping up with the latest developments, I accept there is an argument not to be licensed. Is there a line? I am trying to get it in my head.

Mr Parker—There is probably some intermediate ground where if a person has specialisation in a particular area such as taxation either they be granted a licence to practise in that particular area, which would be subject to appropriate conditions by ASIC, or it might be that division 7 could be used to allow those persons to give advice within their particular area of expertise but not other financial advice. Does that answer your question?

Senator CONROY— Because I am not a lawyer and I do not know what you get up to, and I am just a naturally suspicious person, I was hoping you might be able to clarify. You said tax, and okay, in my mind, that makes some sense in terms of a category of your members. Are there other specific categories? I am happy for you to include this discussion, if you wanted to go away and think about it, in your supplementary submission.

Mr Parker—I can certainly provide one instance in a totally different area. Family lawyers very often will provide advice to litigants over the consequences of Family Court settlements, how one outcome might affect them and the financial consequences of that compared to another outcome and the financial consequences of that—for instance, retaining possession of the house, taking on the mortgage, paying out the mortgage. All those things involve incidental financial advice.

Senator CONROY— Real estate agents assure us that, because of their experience, they are magnificently qualified to give incidental financial advice to people wanting to buy their homes or make investments in homes. Do you think their experience is sufficient for them not to be licensed in terms of financial advice?

Mr Parker—I do not know that I would like to comment on that.

Senator CONROY— That is all I have got, Chair.

CHAIRMAN—Thank you very much, Mr Parker, for your evidence to the committee and your answers to our questions.

Senator CONROY— We look forward to seeing his—

CHAIRMAN—Yes, you will provide a supplementary submission, as indicated?

Mr Parker—Yes, we will provide a supplementary submission.

CHAIRMAN—We look forward to receiving that.

Proceedings suspended from 12.23 p.m. to 1.34 p.m.

BOOTH, Mr Dallas Wayne, General Manager, Statutory Classes, Insurance Council of Australia

DRUMMOND, Mr Robert, Executive Manager (Operations), Insurance Council of Australia

CHAIRMAN—Welcome. We have before us your submission which we have numbered—no, I am sorry, we do not have a written submission.

Senator CONROY—That will be because there was not enough time.

CHAIRMAN—That is not true, Senator Conroy. Now just behave yourself. Obviously you will want to make a detailed statement, then, in the absence of a written submission, so I ask you to proceed with that and then we will move to questions.

Mr Drummond—Thank you, Chairman. ICA welcomes this opportunity on behalf of its members to appear before the committee today. We will be making a written submission and we do very much welcome the extra time that has been given to provide these to you.

ICA made an extensive submission to Treasury and to this committee in response to the draft provisions of the bill, and generally we do applaud the extensive consultation that has been a feature of the government's approach to this very significant piece of legislation. ICA was particularly pleased to recognise that the great majority of the recommendations we made in our earlier submission have been acknowledged and are reflected in the bill. From the outset, ICA has supported and welcomed the concept of a single licensing regime and the consistent and comparable product disclosure framework. In our discussions with Treasury and in presentations we have made, within that broad framework we have consistently sought an appropriate level of flexibility in the disclosure regime. We acknowledge that the bill has addressed a large measure of these concerns by providing flexibility in the form and content of disclosure documentation, particularly in relation to the existing and familiar documents that insurance customers now expect and get regularly. The Insurance Council welcomes some of the key definitions in the bill. The definition of personal advice is helpful and we acknowledge positively that it does not include the provision of factual information or the interpretation of information.

The bulk of ICA's concerns about the earlier draft provisions of the bill have either been addressed or we can expect them to be addressed in the transitional arrangements, in the regulations or in the future ASIC policy statements. Of our few remaining concerns, ICA will set these out in a written submission to the committee. By their nature, we can expect that a number of them will be addressed in ASIC's policy statements and, with that in mind, ICA has been working very closely with ASIC in recent months to ensure an adequate understanding of our industry's practices and usage.

We would like to take the opportunity of today's hearing to draw to the committee's attention three remaining provisions in the bill which we feel, if left unattended, would have significant adverse impact on the sale and distribution of general insurance products. The first issue relates

to the requirements contained in certain sections of the bill to provide oral summaries of the disclosure documents at the point of a telephone sales call. ICA set out its concerns at some length in its earlier submission and they have not been addressed or accommodated in the bill. Many ICA member companies operate telephone call centres and handle significant numbers of consumer inquiries and sales. They believe that to provide the extensive oral summaries over the telephone will greatly lengthen the average time of a routine sales call. We believe that this is likely to be the point where the extra cost and inconvenience to the consumers would far outweigh any intended consumer benefit and could effectively turn customers away. I would be glad to expand on these particular views to the committee.

The second concern that ICA has with the bill is the apparent lack of clarity relating to the express provisions for workers' compensation and CTP, or compulsory third-party motor insurance. Section 9 of the Insurance Contracts Act provides that that act does not apply to or in relation to contracts or proposed contracts entered into for the purposes of a law that relates to workers compensation or compensation for the death of a person or injury arising out of the use of a motor vehicle. ICA believes that without an express provision excluding workers compensation and transport accident insurance it remains unclear if the FSRB applies to these classes of insurance.

This issue of whether these statutory classes of insurance will be subject to the legislation is an important one for ICA members. It was the subject of a major recommendation in ICA's earlier submission. We believe that the bill presents a significant opportunity for the regularisation of a national regime covering these classes of business which are presently subject to variant state and territory legislation. My colleague Mr Booth is ICA's general manager of statutory classes and he welcomes the opportunity to address the committee on this issue.

The third concern we would like to highlight to the committee today relates to the application to general insurance of the proposed cooling off period contained in the bill. This was also the subject of recommendations in our earlier submission. There are two aspects of this that concern us. One relates to the application of the cooling off period at the routine renewal of a general insurance contract. The provision is that the cooling off period will begin from the date of the renewal or the anniversary date of the contract. The insurance contract already stipulates that insurers must provide renewal notices or reminders at least 14 days prior to the anniversary date. In practice, most insurers issue their renewals much earlier than this. It seems to us that to provide a further period of 14 days after the anniversary date is an unnecessary and impractical level of protection to the consumer.

ICA believes that a cooling off period should not apply to renewals if the nature and condition of the insurance cover remain unchanged. It should only apply if there has been some change in the cover. This would be in line with the proposed product disclosure statement requirements, bearing in mind that the customer has already tested the product when the cover was first arranged, and for at least 12 months prior to the renewal.

The second concern arising from the cooling off period relates to short-term insurance contracts. Again, this was the subject of an earlier ICA recommendation and it has not been addressed in the bill. It is an issue which is particularly apparent in a class of business like travel insurance. If left unchanged, the present provisions would permit an insured to complete most

of a vacation or a travel plan and then when it looked unlikely that no claim would arise they could invoke the cooling off period and cancel the policy. ICA earlier recommended that the cooling off period for short-term contracts should end on the day before the contract begins. We repeat this recommendation for amendment to the present bill.

In its written submission ICA will make appropriate references to the various specific sections of the bill which generate these concerns we are discussing today. That concludes our opening statement, Chairman. Thank you for the opportunity to make it. We would be happy to answer any questions from the committee. My colleague Mr Booth would particularly welcome the opportunity to address the committee on the issue of statutory classes of insurance.

Mr Booth—Thank you, Mr Chairman. I make a couple of points. The statutory classes of insurance that I mention today are those of workers compensation and compulsory third-party insurance, and I particularly make reference to the eight jurisdictions—the eight states and territories of Australia—which effectively regulate or define these areas of insurance.

At the outset, I make the point that compulsory third party applies to very large numbers of private individuals who purchase and own motor vehicles. It also applies to the biggest fleet owners of Australia, so it is very much both a private insurance for private individuals for their own motor vehicles, and but also something that relates to our corporations and our very large fleets.

In relation to workers compensation, that is essentially a business insurance; it only applies to employers who have employees, but I make the point there that, within the broader context of the Financial Services Reform Bill, special attention is given to small business and, in particular, retail clients of businesses less than 20 employees or in manufacturing, less than 100 employees. In that context I would estimate that falling within that definition would probably be somewhere between 85 and 90 per cent of employers in Australia. So a very large proportion of employers would fall within the retail definition within the current bill.

The next point is that the Commonwealth government has a limited power in respect of insurance. This is recognised in the bill whereby, in section 765A, state insurance and Northern Territory insurance is specifically excluded. That is no doubt as a follow-on from the Constitution. The question is what constitutes state insurance for that purpose, and I will come to the reasons behind that in a moment.

The definition that we have been given from our lawyers is that state insurance is effectively insurance conducted by the Crown in the right of a state or by an entity owned or controlled by the Crown in the right of a state which does not extend beyond the limits of the state. It is often thought that compulsory third-party and workers compensation are both state insurance because they are so heavily defined and regulated by state or territory governments. I do note that in both cases the policy coverage of CTP and workers would be effectively for the Commonwealth of Australia so that in both cases the policy coverage of those policies would extend beyond the state boundaries of the relevant state or territory concerned. I note, though, that compulsory third-party and workers compensation have both been specifically excluded from the purview of the Insurance Contracts Act, and this has been mentioned already by Mr Drummond.

Why is all this relevant? Chairman, I would like to table a brief summary, if I may, of an outline of precisely how the workers compensation and CTP schemes are actually underwritten and operated in Australia. In relation to compulsory third-party insurance, private insurers operate, underwrite and finance this business in Queensland, New South Wales and the ACT. In the other five jurisdictions, the business is underwritten by a state government entity of one form. In New South Wales the compulsory third-party insurance policies are actually sold by the insurance companies or by their agents. In all other jurisdictions the policy is sold by the motor registration process, including in Queensland and the ACT. If we were to apply the framework of the FSR Bill to this particular product, the private insurers would be the licensed service providers or the licensed issuer of the insurance, and then the motor registries may well become the authorised representatives of the insurers, certainly in Queensland and the ACT. So there is a question mark as to how those particular provisions would be applied.

It actually gets a little more complicated in relation to workers compensation. In workers compensation, in four jurisdictions we have a private sector competitive market: they are Western Australia; Tasmania; Australian Capital Territory and Northern Territory. In each of those jurisdictions the insurers sell the policies, invest the funds, manage the claims and effectively operate the business, in each case subject to regulatory control and oversight by a state regulator. Queensland has a pure monopoly for workers compensation; private insurers are not involved. In New South Wales and Victoria, insurers sell policies and manage claims; they have the appearance of an insurer but they are actually operating the business on behalf of the relevant WorkCover authority. In the words of FSRB, they would be authorised representatives. In South Australia, the role of insurers is to manage claims on behalf of employers and the WorkCover corporation; the insurers are not involved in the operation of the business.

We can see from a very brief summary that the underwriting and the distribution of both workers' compensation and CTP insurance around Australia varies markedly. The ICA submission was to recognise that from the point of view of a private individual buying a CTP policy or a small business who employs a small number of employees or, better still, a small business that has three or four employees and a van, the information that is supplied to them will vary markedly accordingly to which particular state or territory of Australia they operate in. ICA has therefore called upon the need for consideration to be given to create a single regulatory regime for all classes of general insurance, including CTP and workers compensation, so that, from the point of view of a private individual or a small business retail person, they know precisely where they stand, they know their rights, obligations and entitlements, regardless of the jurisdiction in which they operate.

More importantly, in relation to workers compensation, the private insurers are involved in seven of the eight schemes. They have seven different operating systems, seven training programs, seven computer systems and seven regulatory requirements with which they must comply. The consequences in terms of cost and complexity are obvious. We believe that this is an ideal opportunity for the Commonwealth government, working in conjunction with the states, to bring real benefit for the consumers of workers compensation and CTP policies in Australia. Thank you, Chairman.

CHAIRMAN—Thank you very much, Mr Booth. Before other members raise some of the issues you have raised, can I raise with you the issue of the disclosure of commissions on non-accumulation products. Previously we have had argument from sectors of the industry that

there should be non-disclosure of the commissions on those particular products, what is the council's on that?

Mr Drummond—The council's view is that there should be disclosure of all forms of income that the customer pays for advice. It comes down do the spirit of the bill which says, 'If someone is comparing products or where and when they are getting advice, they should understand the cost they are paying for that advice from a particular source.' For that reason, the disclosure of commission seems totally appropriate.

CHAIRMAN—So there remains this difference between you and the insurance agents on the issue?

Mr Drummond—Yes, we are aware of the views of the insurance agents, but it is difficult in our minds to separate the intent of the bill and the intent particularly of the disclosure requirements of the bill from a view that commission is not one of the features that a consumer should be able to compare when examining which product and advice to take.

Senator CONROY—On car insurance they should have the commission disclosed, or life insurance?

Mr Drummond—If they are paying for advice in the context of buying that car insurance, then they should know what they are paying for that advice, and for the service that is being provided by the intermediary.

Senator CONROY—I am not sure you are answering the question we are perhaps trying to ask—and perhaps it is more that I am not asking the right question. You dropped to the definition of when giving advice: are there circumstances when you would buy car insurance or life insurance where you are not giving advice but you are just selling a product and there is no advice involved in selling of the product?

Mr Drummond—Yes, there could be circumstances where there was a perfectly straightforward product which had no options or there was no need to consider the personal circumstances of the consumer, and it may be in those circumstances where—

Senator CONROY—What sort of products would fall into that category?

Mr Drummond—Certainly car insurance would be one; CTP insurance perhaps, yes. But if the customer went on to ask, 'Are there alternatives?' or 'What level of excess should I prudently go for?' that would probably involve asking the consumer, 'Can you afford a certain level of excess or can't you?' for example. So it is very difficult and our members have researched this, Senator, very carefully. It is very difficult to find circumstances where personal advice will not be given at the point of an insurance sale. There will be circumstances where it is possible and it will not be.

Senator CONROY—So you think WorkCover and third-party insurance, things like that, should not be included because it is clear that one size fits all, irrespective of personal circumstances in other words? If you are buying third party, everyone pays the same, irrespective of personal circumstances?

Mr Drummond—If there is a standard product with no variations and it is unaffected by the personal circumstances of the consumer, yes, it is probably fair to say that there would not be any element of advice in that transaction.

Senator CONROY—Would you think that would be the case for, say, life insurance?

Mr Drummond—I would think it most unlikely. Life insurance is certainly getting into areas of personal objectives, financial position, financial needs, and it is very difficult to imagine that life assurance could be arranged without giving personal advice.

CHAIRMAN—What about a term form of life insurance?

Mr Drummond—Again, the reason for the consumer buying it, the reason they need it, whether it is the right product to meet their financial objectives—would require advice from many people.

CHAIRMAN—The bill draws a distinction between retail and wholesale clients. For instance, it defines the sale of crop insurance to a farmer as a wholesale transaction, which could involve insurance against fire in a crop, and yet the sale of a fire insurance policy to a home owner is a retail product. Disclosure is required with the retail product but not with the wholesale product. Can you see any logic in drawing the distinction there?

Mr Drummond—It is an attempt by the bill to draw the distinction between a consumer who perhaps needs a level of protection when buying a financial product and a body, company or entity who perhaps could be considered not to need the same level of protection because they are a corporation, a business, or they are familiar with financial transactions. That is my interpretation of the spirit of the bill.

CHAIRMAN—You can have fairly small-scale farmers who may not be sophisticated business people.

Mr Drummond—Yes. That would probably be taken care of by the definition of small business in the bill as employing less than 20 employees.

CHAIRMAN—But the definitions are part of the product rather than the business.

Mr Drummond—No, it applies to the number of employees employed by the firm—100 if it is a manufacturing firm; 20 if it is another form of business. Most small farmers would fall within that definition.

CHAIRMAN—As I understand it, the disclosure requirements apply to the definition of the product, and crop insurance, for instance, is defined as a wholesale product, irrespective of the person that is buying it. So the definition of small, whether it be—

Mr Drummond—Certainly if the product did not fall within the definition of the retail products being sold, yes, the customer would not get the benefit of the disclosure protection.

CHAIRMAN—Can you see any logic in that?

Mr Drummond—I can, Senator, yes.

CHAIRMAN—Can you explain that? Because it is not relating to the size of the farm, it is purely the nature of the product.

Mr Drummond—Again, crop insurance would tend to be related to the broader commercial covers that the farmer is buying, the insurance of his equipment and machinery, his fencing, outbuildings, crops and stock. It has been recognised that the level of protection that is required there is probably less than for a retail customer. It is certainly a point well made, Senator.

Senator CONROY—Boat insurance? Disclosure of commission is what you believe is in the bill?

Mr Drummond—I believe it is a retail product. I come back to my point, Senator, that to me disclosure of commission should relate to the level of advice that is given and what the customer is paying for advice. If there is advice involved in the purchase of boat insurance, then commission should be disclosed.

Senator CONROY—– You are giving your opinion of what should be in the bill or what you think is in the bill?

Mr Drummond—What I think is in the bill.

Senator CONROY—There seems to be a great deal of confusion in the industry. I have some phoning me and saying, ‘No, for risk product there is no disclosure required,’ and others, like you, saying to me there is disclosure required on your reasoning of the bill

Mr Drummond—I believe disclosure is required. There are three disclosure documents, in two of which commission has to be disclosed, and the third, the product disclosure statement, it does not have to be disclosed. I believe the provisions of the bill, as they stand, are appropriate.

Senator CONROY—And that they do cover risk product—life insurance?

Mr Drummond—Yes.

Senator CONROY—I am receiving advice from others who think, after reading the exact same piece of legislation as you and I, that they do not think it is. Can I read you, as an example what the Association of Financial Advisers believe:

> These documents, the Financial Services Guide and Product Disclosure Statement, state that commission will be disclosed so clients may understand how they pay for the service, and where commission has no effect, disclosure is not required.

We are all reading the same bit of legislation and I am just trying to find out how many people have different views on what the same words mean, and I am not a lawyer.

Mr Drummond—That would not be my interpretation of the bill. I should hasten to say that I am not a lawyer, I am an insurance practitioner, but that would not be my interpretation of the bill. My interpretation would be that commission would have to be disclosed in at least two of the three disclosure documents.

CHAIRMAN—Each customer gets all three documents?

Mr Drummond—Yes.

Senator CONROY—This is in a magazine, but I have also been receiving correspondence telling me they believe it is excluded specifically. I have struggled to find out why they think that so I was wondering whether maybe I am reading it wrongly. Hopefully I am right and you seem to be agreeing, so I am relaxed. I hope we are both right.

Mr Drummond—I am glad I came.

CHAIRMAN—If there are no further questions, can I thank both of you for your appearance before the committee and the evidence you have given. We will take it into account in finalising our report on the bill. Thank you very much.

[2.05 p.m.]

DRODER, Mr Stan, Director - Public Practice, CPA Australia

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

STREETER, Ms Kathryn Laurayne, Financial Planning Industry Adviser, CPA Australia

CHAIRMAN—I now welcome the representatives of Certified Practising Accountants Australia and the Institute of Chartered Accountants in Australia. We have before us a document which the committee agrees to receive as a submission. Do you wish to make an opening statement in relation to the document?

Ms Streeter—Yes.

CHAIRMAN—Please proceed and then we will move to questions.

Ms Streeter—First of all, we would like to thank you for allowing us to make a submission and to provide evidence today. The accounting bodies still do support in principle the underlying objectives of the bill – that being to create the single licensing regime for the financial services industry – but at this stage the accounting bodies cannot provide full and unconditional support for the bill, primarily because several issues still remain unclear. That has arisen for a number of reasons: firstly, because we do not have all the material as yet, particularly the regulations; secondly, the material that we do have we have not had a chance to review in full, for example, the policy papers which came out yesterday afternoon, but also the material that we have had a chance to review we still believe has not clarified a lot of the issues—in particular, who is and is not going to be caught by this licensing regime.

That becomes particularly important when you look at who we are trying to represent. Combined, we have over 110,000 members. We have 3,000 to 4,000 members who would either be licensed or proper authority holders, and obviously we need to look at the bill in terms of the provisions they are going to have to abide by by in the disclosure regime, et cetera, and we touched on some of those issues. We also have probably around 20,000 public practitioners who are providing traditional accounting services and may be unintentionally caught up in some of the licensing provisions of the bill, and we are still unclear of that; and there are a further 80,000 members, who are part of our wider membership, and we need to ensure they have not been unintentionally captured by the licensing regime. Our submission has focused very much on the issues of clarification of who is and is not going to be captured by the Financial Services Reform Bill.

The other issues touched on in the paper include the definition of wholesale versus retail client, ethical investment disclosure laws and the impact of the bill on superannuation and superannuation trusts.

Mr Reilly—Again, I would like to thank the committee for extending the time for submissions. The submission you have in front of you today is a draft submission and it was still being worked on on the word processor at about 12 midday today. I expect our final

submission will probably go into a little more detail on some of the specific issues in terms of licensing and the issues that are covered in the bill itself. I have not yet had the luxury to have the printed copy of the bill, but that is the printed out copy which I have been working on—500-odd pages—and the explanatory memorandum there as well.

The other pile of papers here is the first series of ASIC policy papers that were issued yesterday afternoon, of which we have had a very quick read of overnight, but there is further material to come here as well. In the submission that you have in front of you we have expressed our frustration with our inability to be able to work with government to determine who has to be licensed at the end of the day. We have argued, going back to 1997 when the original Corporate Law Economic Reform Paper No. 6 was issued, that we needed to have certainty as to who had to be licensed and who does not. One of the difficulties that the regulator, ASIC, has had over a period of time is at that fringe level where you are giving specific financial product recommendations. We quite clearly support the view that the existing legislation requires those people to be licensed, and we believe that should continue, and that is how I have understood the intent of this bill.

We have included in this submission a copy of our earlier submission to the committee last May, because it provides further detail as to how accounting practices and members are organised and the services they provide to the public at large, but also services they apply internally within their own organisations, particularly when they are working in corporate organisations. We do note that the time period has been very tight and, as I said, we are very appreciative of the committee extending the time period further.

We have some concerns over the amendments that have been made to the 2001 bill, because we are not sure exactly whether, without going through page by page, what might be seen by some as minor amendments are in fact significant. In other cases, some of the significant amendments are new amendments that we will want to consider. So the time period is very short. We are a membership-based organisation so rather than having three people here representing the accounting bodies we do need to go back to our membership and committees to get their input and, in the time period that we have had, that has proved to be somewhat difficult—hence the reason that over the next two weeks we will be talking further with our committees and looking at specialised areas like superannuation and the impact that the bill has there.

We have also drawn attention to the very useful role that the Business Regulation Advisory Group, BRAG, has had and, Senator Gibson, you might recall in your time that I am sure you found BRAG quite useful. We are disappointed that, whilst BRAG was asked by the minister to provide any comments in a very short period of time in early February, BRAG as a group was not asked to sit down and go through the bill in some detail. That is a shame for a number of reasons, but one particular one which would affect your committee's workload is that I would see BRAG as being perhaps the first filter before legislation goes into parliament and then is perhaps referred across to particular specialised committees.

I have said that we have briefly—at least one of us, maybe two of us—skimmed through the ASIC material that was released yesterday afternoon. This bill is sufficiently important that we understand the regulator's interpretation of the bill when we have had some difficulty understanding where the bill is heading to in particular areas. I would note that even the ASIC

package of material which is here is only the first package to be released. In the submission itself we note that there are further papers that are due to be released right through to September-October 2001, which raises questions in our minds as to an implementation date of 1 October 2001 when the regulator itself has yet to actually explain how it will in principle regulate the proposed act. Again, ASIC has also asked for comment on those particular provisions, so a September-October means October-November at the very earliest.

One particular issue which we have mentioned in our submission is declared professional bodies, and I point out there that whilst ASIC has said that it will be releasing a draft policy paper on that issue it has not even given a date for that so I can only presume that that will be issued some time over September-October. It has a little difficult to provide specific comment on how that particular provision is likely to work when we know the regulator has not really addressed it as such.

We also note that the minister's 5 April press release states that a separate bill will be introduced in the winter session of parliament; regulations will come through at some later date and, as has become more common, often the devil is in the regulations rather than the legislation itself. So again it is somewhat difficult to provide specific comment on particular issues, knowing full well the regulations are well down the track. Our preference would be to have the legislation as clear cut as possible, to have the regulator issue policy statements as to how that legislation would be implemented, but we do not think it is appropriate for the regulator to actually be effectively writing legislation.

In terms of the licensing provisions, I have said earlier on that we have raised this issue with your committee since the 1997 CLERP reform paper No. 6, and we have been in discussions with ASIC well before that period of time as well. Our interpretation—which may be ASIC's and may not be – is that the bill is really intended – and I quote from the explanatory memorandum, section 4.4, which states:

> A single licensing regime will replace licensing requirements currently applying to securities dealers, investment advisers, futures advisers and brokers, general life insurance and foreign exchange dealers.

We believe that the intent of the legislation is to effectively replicate the current licensing requirements in the existing Corporations Law and pick up general life insurance, futures advisers and brokers, foreign exchange dealers. From that point of view we are supportive of that. We note that there are various sections in the legislation that then define who is required to hold a financial services licence, and we take some comfort from the fact that the key definition appears to be of financial product advice, which is a recommendation or statement that is intended to influence a person to make a decision in regard to financial products. So we have taken that to mean that this legislation would require a financial services licence where you are actually making a recommendation on a specific financial product. That we support. However, we think it would be useful, particularly as we have the regulator who is required to administer this legislation, for a specific statement to be made in either the explanatory memorandum or in the bill itself as to what other activities are intended to be caught by this legislation. We support that, if you provide a specific financial product recommendation, you are currently required to be licensed, and we support the fact that the bill should continue to require that to be licensed. But if it is the intention or if it ends up being a fact that the legislation will require other activities to be licensed, that should be spelt out. We may not agree, but at least it would require

clarity. Without clarity there will be additional costs in terms of ASIC, in terms of industry bodies and, finally, to the consumer at large, and that certainly is something to be avoided.

We note that the ASIC paper No. 1—and again, having only skimmed it last night— *Licensing, scope of the licensing regime, financial product advice and dealing*, does provide some background as to how ASIC will interpret the licensing provisions, but at this point in time I am not in a position to say how it does affect particular activities. For instance, if you are providing traditional tax advice to a client and the tax advice has nothing to do with buying or selling BHP shares, by way of example, but it is to do with the company structure, is that something that the tax adviser would need to be licensed for under this particular legislation; we would argue it should not be. But that is the sort of example that we need. Instead, what ASIC has done is provide examples in terms of Internet portals, call centres, travel agents, talkback radio and newspaper columnists. We would expect hairdressers and others will be caught at some later stage. But what we are really looking for is a couple of examples of the sort of activities that accountants do to say, ‘Are they caught or are they not?’, and that is what we are lacking. We will be in discussion with ASIC on that, and ASIC has allowed a period of one month for comment, and no doubt that will run out for some period of time.

In terms of declared professional bodies, the accounting bodies have supported those provisions but not as a catch-all provision to catch financial advice which may not be specific product advice but could be seen as being somewhat close. So we do not believe it is appropriate to have a sweep-all provision for a number of reasons. First, ASIC still has the same requirements to be happy that the declared professional body is licensing in the appropriate manner. All we see the declared professional body doing effectively is a mechanism for ASIC to relieve itself of some of the administrative burden of licensing certain professional people. Whether we would actually use the declared professional body provisions is something on which we have not made a decision. One of the reasons is that even ASIC has yet to detail how it will administer those particular provisions. The committee might recall that in comments on the 2000 bill ASIC was strongly opposed to those declared professional body provisions. Before we can make a decision on that, we would need to see what ASIC’s intention is.

As Kathryn has already said, we have some 110,000 members. At the moment we understand there are about 2,000 licensed dealers and about 30,000 PAs. If we are required to have the majority of our members, or even some portion of our members, above the 3,000 or 4,000 that are already licensed, licensed, then I am not too sure it is necessarily in the accounting bodies’ own interests or even in the members’ interest to impose additional costs by having the accounting bodies do that. It may well be more convenient for ASIC to have that done. We would have to make that call at some later stage.

There are a number of other issues we have covered in the submission. I might just hand back to Kathryn, if there are any particular issues you would like to draw to the attention of the committee.

Ms Streeter—On the first one there—definition of retail versus wholesale client—there are several criteria used to define retail and wholesale client, one of which is that benchmark of $500,000. It is not unreasonable for someone approaching retirement to get a lump sum of $500,000, and they could unintentionally fall into the definition of wholesale client and therefore lose a lot of the consumer protection measures, which seems pointless, given that that

is the whole intention of the bill is to provide consumer protection. Given there are other criteria for assessing whether someone is a wholesale client or not, the question is raised as to whether you need that particular single product limit. If it is still considered necessary, there would have to be some other benchmark such as the RBL lump sum limit or the pension perhaps, because that is an index limit as well, so things would move up.

We also support in principle the Australian Conservation Foundation and their moves to have ethical disclosure requirements put in place. We have also commented on some superannuation issues—

Senator CONROY—There is an alliance to worry about.

Ms Streeter—In principle.

CHAIRMAN—I would have thought that was making the provisions unnecessarily onerous.

Ms Streeter—The accounting bodies have supported ethical disclosure. We support triple bottom line accounting and various other disclosures in financial statements in ethical investments. So it would seem natural that we would also support ethical disclosure in the financial services arena as well. In principle, we want to see how much detail would come out.

Senator GIBSON—Is that necessary in the law? If people want to disclose, or there might be an advantage in doing so, or they perceive it, because that is what people perceive, why should we clutter up the legislation with that?

Ms Streeter—Don't people have a right to know? The people who do not disclose it are probably hiding something.

Senator GIBSON—I am just questioning that assumption. It would seem to me that it is an unfair assumption to make that the people who do not make it are doing some unethical.

Ms Streeter—The whole point of the disclosure is so that consumers can make an informed decision about the investments that they choose. Ethical issues are becoming increasingly important for consumers. It is just simply so that consumers can then make an informed choice as to whether they wish to invest in that product or not, having all the information in front of them.

CHAIRMAN—But can they not ask about that? Why should that be a mandatory disclosure requirement?

Ms Streeter—Because it is becoming increasingly important for consumers to consider that.

CHAIRMAN—A lot of consumers are simply interested in their financial return. If that is all they are interested in, why should they be cluttered up with this other information that they do not require unless they specifically request it?

Mr Reilly—Mr Chairman, it is a matter of principle and, as we have said, we want to have a look at the detail. There is a fine line, as some earlier witnesses provided, between having increased regulation, which adds a cost, as against the benefit of that particular regulation. We are appreciative and supportive of the fact that there is information generally required or expressed by a significant part of the Australian population who are looking for that type of information. So the lead can be taken in two ways: it can either be voluntary, in which case some organisations will see a market advantage for it; or it can be legislated for. In terms of legislation, we would want to have a look at the fine detail and we would be conscious of the fact that we would not want to add unnecessary costs that are seen as being onerous; it is a balancing issue. That is why we said 'in principle.'

Ms Streeter—I did not want to comment too much on the superannuation; I would rather take any comments on board.

Mr Reilly—If I could make a final comment, I said earlier on that we have been a little disappointed that we have not been able to work more closely with government, particularly on drafting provisions to seek clarity. We repeat our earlier offer that we would be delighted to work with government or Treasury officials, ASIC and your committee. We will be following the progress of the further hearings of this committee on the Financial Services Reform Bill 2001. If your committee requires any further information, both Kathryn and I are available to meet with you as a committee or individually.

Senator CONROY—I am unfortunately at an even greater disadvantage than Mr Reilly as I have not had a chance—because I was in Sydney last night—to pull anything down from the Web to read the extra 300-odd pages, with promise of more from ASIC. Unfortunately, I am not in a position to ask many questions, because I have not had a chance to read them yet.

I am sure you heard me earlier, Mr Reilly, expressing an apology, certainly on my behalf and probably the committee's, about the short timetable and the incapacity to allow sufficient consultation. It seems a manic determination to try to get it passed in the next three or four weeks of sittings, which is highly unlikely, given the degree of scepticism that appears to be emerging, particularly the lack of consultation.

CHAIRMAN—Your efforts to consult with the government: your comment there is in relation to getting feedback from the government, is it? You have made your submission on the draft exposure bill, as we did.

Mr Reilly—Yes.

CHAIRMAN—What you are saying is you have not had any direct consultation with them since you made that submission?

Mr Reilly—That is correct. We have made it quite clear in our submission that we would like to work with government to clarify, because it wastes our time, to be honest, at the end of the day and that of our members if we are continuing to argue with regulators and others as to just what the requirements are. As I said before, we may not agree with some of the requirements, but at least we need to be able to advise our members, 'If you are doing tax returns, do you have to be licensed under the Financial Services Reform Bill?' I would draw attention – I am sorry,

Senator Conroy – to ASIC's papers. At one part in the licensing provision ASIC refers to what you do if you are giving broad asset allocation advice; whether that is caught by the licensing requirements or not. ASIC have said, 'No, it is not; it is only when you go down to the specifics.' We might agree or disagree with ASIC but at least that is an interpretation that has been given. We will have the opportunity to argue that through.

Another area in the licensing paper No. 1 refers to the issue of fees. The bill is quite clear in saying whether you are required to be licensed or not should not be determined by whether you have charged a fee and what type of fee; agree or disagree. ASIC at one part in their draft policy has said that, if a fee is charged, then that leads you towards being required to be licensed. In another instance, ASIC has said, 'If it is only a fee for advice, then it is not a commission.' In other words, you are giving advice and you are being paid a fee for that, but you are not then being paid a commission—if the person actually purchased the product, then that would not lead you down the licensing path; it would be the commission side. I am not trying to be critical of ASIC; ASIC has done a fabulous job in putting out all this material as the first part of the package, but they are the sort of issues that need to be addressed. Ideally, they probably should have been addressed back at the bill stage.

We think the bill is terribly important; we are supportive of a single licensing regime. We can understand we would not support moves to rush legislation through because, having put legislation through parliament, the last thing anyone wants to do is then go back and propose amendments to that legislation. Even though there are transitional provisions for, say, a two-year period, if some of our members who are not currently licensed are required to be licensed, we see it as a total administrative nightmare to get those members licensed, even via the ASIC licensing provisions, let alone by using a declared professional bodies regime. So we would be encouraging government to proceed carefully, given the importance this legislation has. That may not suit the timing of parliament this year, but we think this bill is probably more important than an impending election.

Senator GIBSON—Mr Reilly, given the concerns you have raised with us in this document and you have just outlined, from your perspective how much time is required to consider these matters? If the government pulled out all stops to accommodate your requirements and work closely with you in pursuing these matters, can you give us your perspective on timing?

Mr Reilly—I would have to say that I am not a licensed financial adviser, so I am wary about giving advice. When the 2000 bill was issued, it was issued for a four-month comment period, and the chairman picked me up last time round by saying that having the committee require submissions within a two-month period was unduly onerous. These provisions are so important that a four month period of time is appropriate, particularly for industry bodies to go back and consult with their members. We could all sit down with government in a two-week period and get agreement on the wording of specific provisions, but the benefit is then to expose those back to the membership, so I would say a four-month period. In reality, the timetable really is going to be driven by ASIC. If ASIC is unable to get its package of interpretative draft policies out before September-October this year, ASIC is probably telling you that it needs a further period of time. Realistically, you are going to run through to the end of the year.

Senator CONROY—Are you comfortable with so much of the detail being left to ASIC rather than being contained in the bill?

Mr Reilly—No, I do not believe we are. In earlier comments I should have made it a little clearer. The legislation should be quite clear cut. We believe there is a place in the explanatory memorandum to explain the intent of the legislation, and certainly we do not believe that ASIC should necessarily have had to release policy paper No. 1 on licensing to go back and determine financial advice, financial products, those types of links. It is quite useful for ASIC to come out and give examples. That is one of the benefits of a regulator—for the regulator to publicly explain how it is going to administer the legislation. But, no, it really should be in the actual legislation itself.

Senator CONROY—You do not consider that what you are pointing to there is in fact the interpreting or administering, it is in fact making?

Mr Reilly—My fear is that the comments of the accounting bodies when we comment back to ASIC will be that we will be saying to them, 'More than interpret, you are going to be writing legislation in there because there are deficiencies in the bill because we are left in an unclear position.'

Ms Streeter—One area where it is deficient is class of products; the class of products is not defined in the bill at all. I did notice in that licensing paper that ASIC issued that they broke down what class of products is, which is something I have been wanting to see. But I do not think it should not have been left to ASIC to provide that interpretation.

Mr Droder—Chairman, I have been quiet, but in my role I look after the public practitioners of CPA Australia, which is a similar profile to the public practitioners of the Institute of Chartered Accountants. They are spread all over the country, of course, in suburban Australia and regional Australia, and they are pretty lonely people, let me tell you. They have got a fair degree of uncertainty at the moment, because their reputation with their clients has been as the trusted financial adviser. That is a position that they want to protect and we want to help them protect, and we are always keen to increase the standards and whatever under which they operate in relation to what we have just been talking about.

One of the current issues is around the definition of incidental financial advice, because we understand that ASIC has interpreted that in a very wide way; a way where, according to QC opinion that this organisation has, it has certainly overstepped that mark. I am reminded that in a past life when I was involved in tax law somebody told me that it is very good of the government to write policy, but what you have got to be very careful about is the public servants who have got a big, deep basket of jealousies out here, and they dip into their basket of jealousies and bring out some of their own things.

What I am saying to you now is that there is a whole bunch of poor public accountants practising —overworked with GST, et cetera, I might say too—and frightened of giving incidental financial advice. There is a lot of confusion and concern, and that certainly needs a lot of clarification. They are concerned about their own personal indemnity. There is a view that if they so-called breached ASIC's opinion about what is incidental financial advice, their PI insurance would not cover them, so it is a personal thing, that is a worry for them. I was thinking while we were talking about that this morning. I look after a woman whose husband was killed in a car accident. I have had to talk her out of taking a negative gearing position, which one financial adviser told her she should take—this is a woman with an income of

$15,000 having it suggested she negative gear. It was absolutely ridiculous. I see it that our role as trusted financial advisers is to bring some sense to some of those advisers, and that is an area in which, as an individual, I will fight very hard for our members. Thank you.

Senator CONROY— I look forward to seeing you again before the committee soon, I hope, after we have all had a chance to read all of the legislation and practice notes.

Mr Reilly—Just a final comment. We have referred back to the financial system Inquiry, the Wallis report, where the following statement was made – and I had some sympathy with our legal colleagues earlier on this morning:

Professional advisers such as lawyers and accountants often provide financial advice … in the context of broader advisory services offered to clients extending beyond the financial sector, often where the adviser—

such as Stan—

has a wide appreciation of the business and financial circumstances of a client.

What the Wallis Inquiry was saying is that the best course is to rely upon the professional standing, ethics and self-regulatory arrangements applying to those professions.

Your committee, in its report to government, essentially said much the same thing. I am not too sure that the bill picks that up at all; the bill may be attempting to pick it up by the declared professional bodies route but as the Financial Planning Association, in its submission here, has already said to you, it sees declared professional bodies as meeting the same licensing requirements as are required to be met by those who are currently licensed. There is quite a difference between the two. Certainly our profession and I believe the legal profession are able to say that we are self-regulatory and we are able to provide appropriate consumer protection measures. To take it to the next step in the securities industry area, you are looking at some fairly significant numbers of people coming in and being licensed. I would ask: where is the cost benefit of that?

Senator CONROY—Mr Hockey, in his speech and in yesterday's *Business Review Weekly*, makes the point that he sees this as touching on 330,000 providers?

Mr Reilly—It could be; we are—

Senator CONROY—I am just trying to work out if, in his head, he thinks that there are 330,000 financial planners out there. I am sure there are not, but he would have to be roping you in then.

Mr Reilly—I would have thought so. We have been working with our colleagues from the New Zealand Institute of Chartered Accountants who have members out here who are providing financial services advice but are not working in the securities industry as such. They have made the comment that a declared professional body is not going to help them, because it is unlikely that the New Zealand institute would see reason to go through the process. If you look at the way the economy operates from a global perspective, that is probably not the right way to capture it.

CHAIRMAN—On the issue of consultation, you said you have not had feedback. Are you aware whether other organisations have had feedback on their submissions?

Mr Reilly—No, I am not aware that any organisation has had feedback. Certainly we have spoken to the Financial Planning Association and ASFA, the Australian superannuation people; we are not aware. Comments were taken by Treasury; a revised bill was prepared and the Business Regulation Advisory Group were given a copy of that bill in late February to provide comment but on a very short period of time—the bill was tabled in parliament shortly thereafter.

CHAIRMAN—From your knowledge, in all cases it was simply a matter of receiving submissions and then the legislation being drafted; there was no ongoing consultation in the legislative drafting process?

Mr Reilly—I am not aware of any. In fact, I would ask your committee the same question, because you heard evidence from us on 30 June 2000 and provided a report to government in August 2000. Have you had any further consultation with government until the 31 March 2001 response by government came through? I am not sure I am allowed to ask that question.

CHAIRMAN—The committee ordinarily would not have ongoing consultation; we would wait for the response, but certainly members of the committee informally would be involved in ongoing consultation.

Senator CONROY—Some members.

CHAIRMAN—Thank you very much for appearing before the committee and the evidence you have given to us. We look forward to your further submissions.

[2.47 p.m.]

KERR, Mr Michael John, Legal Advisor, Australian Conservation Foundation

CHAIRMAN—Welcome, Mr Kerr. We have before us your submission which we have numbered 22. Do you wish to make an opening statement?

Mr Kerr—Yes, I wish to make an opening statement and to point out two small amendments to the submission.

CHAIRMAN—Yes, perhaps if you do those first.

Mr Kerr—The amendments relate to the fact that the ACF submission relates to the draft Financial Services Reform Bill. The bill is now tabled so it is a bill, so we would make all references to 'draft FSRB' be in relation to the Financial Services Reform Bill. Secondly, since the draft version I understand that part 7.8 of the draft version relates to the product disclosure statement, and the uniform disclosure requirements are now in part 7.9 of the bill. So any reference to part 7.8 in our submission is a reference to 7.9.

CHAIRMAN—Thank you. I invite you to proceed with your opening statement and there will probably be some questions.

Mr Kerr—Before I proceed could I hand to the committee some further documentation that perhaps you could refer to whilst I make this statement. As is evident in our submission, ACF's interest in the bill relates primarily to part 7.9 of the bill in relation to the uniform disclosure requirements contained in the bill and, more specifically, the product disclosure statement that is proposed to be provided to all retail clients on the issue or sale of a financial product. According to the commentary which accompanied the draft version of the bill, the broad objective of product disclosure is to provide consumers with sufficient information to make informed decisions in relation to the acquisition of financial products, including the ability to compare a range of products. This is now reflected in the objects of the bill of the bill itself, which includes an objective to promote the confident and informed decision making by consumers of financial products.

I do not intend to explain to the committee, because I am sure you are already aware, what is currently proposed to be included into a product disclosure statement. I can, if the committee wishes, but I will assume that the committee is aware of the information that is currently proposed. What I would like to say is that the current information that is proposed to be included in a product disclosure statement is not sufficient to meet the bill's overall objectives that I just outlined. Accordingly, through the submission, the Australian Conservation Foundation and a number of other organisations have proposed an amendment to the bill and, more specifically, the product disclosure statement provisions of the bill. Included in that package of information that I handed to you is an outline of the amendment that we are proposing. It appears on the first document. I have also outlined it in a more simplified version in the submission itself.

What the amendment will do is expand the kinds of information that is to be included in a product disclosure statement to include a statement of the kind that I have included in the proposed amendment. I will read the statement or the details we think are necessary to be included in the product disclosure statement. They are: details of the extent, if at all, to which environmental, social or ethical considerations are taken into account in the selection, retention and realisation of the investments.

The amendment that we are proposing will only relate to certain financial products. The draft amendment that you have before you applies only to investment life insurance products, managed investment products and superannuation products. They are three very similar products and they require special treatment, you could say, with some extra information provided to consumers on the sale or issue of those types of products. When I say they are similar, they are functionally equivalent, because they consist of an investment component through which consumers of the product are seeking to generate a higher degree of return. Accordingly, they carry a greater degree of risk and, lastly and most importantly, consumers have no control over the use of the investment to generate that return. In other words, the funds are in the hands of the fund manager. They are the three products that I propose that the extra information applies to. They are defined in the Financial Services Reform Bill in part 7.1 of the bill.

Why do we see there is a need for this extra information in relation to the three products that I have just mentioned? I will give three reasons. The first reason is that there is a growing demand for ethical investment products. There would not be a week that goes by where there would not be an article in one of the major national newspapers in relation to ethical investment. I have included an article which typifies the articles in your package there. The article I am referring to is the *Financial Review* article by Jacki Hayes dated 11 April 2001 relating to Rothschild's moves to establish their own ethical investment trust.

The kinds of figures quoted in these articles are always the same—they are coming from the same source—and they use them to exemplify the fact that ethical investment is becoming mainstream now and becoming very popular. I ask you to refer to the article specifically where they talk about the fact that overseas, in the last decade, ethical investment has grown by 50 per cent in both the United States and the UK. In the United States, the equivalent of $A4.05 trillion is currently invested in ethical investment products. That is one in every eight dollars.

CHAIRMAN—What is the definition of trillion? Is that a billion billion or a hundred billion? It is a thousand billion, so it is an American trillion.

Senator CONROY—A lot of money.

Mr Kerr—It is a helluva lot of money, you might say. One in every $US8 invested is invested in an ethical investment product. In Australia it is about a billion dollars.

CHAIRMAN—Sorry, that was in America, was it?

Mr Kerr—Yes, that is the United States.

CHAIRMAN—I thought you said Australia; it seemed a lot for Australia.

Mr Kerr—Yes. I do not think that there would be that kind of money in the market at all, let alone in ethical investment. As I said, $A1 billion is currently invested in ethical investment products. All commentators agree, and it evident in this article, that ethical investment is soon to become mainstream; if not, it already is. That is evident in the fact that financial institutions such as Westpac, AMP, Rothschild and even the Commonwealth Bank more recently—

Senator CONROY—Oil companies, accountants—it is a shame file.

Mr Kerr—It is, you might say. But certainly it is mainstream, there is no question about that. If it is mainstream and consumers are now demanding an ethical investment product, it is important that if we are going to develop a disclosure regime for the 21st century for financial products it must include information in relation to the ethical credentials or the ethical nature of the financial product and, more specifically, investment products themselves.

The second reason I identify and the reason for the inclusion of the extra information that I have outlined is in relation to the superannuation industry. The superannuation industry is poised soon to experience significant change, that is, if the federal government’s proposed members’ choice superannuation funds bill ends up going through parliament. Through that bill it is proposed that workers have a choice as to which super fund their compulsory contributions are to go to. Currently, they do not have such a choice; the employer chooses which fund the compulsory contribution should go to.

Like the wider ethical investment market, the superannuation investment market is also experiencing a trend towards ethical investment. A recent KPMG survey found that 69 per cent of respondents stated that, if given the choice, they would invest their super funds into an ethical investment super product. So if the federal government is going to introduce members’ choice legislation and reflect the growing trend towards ethical investment, it is important that workers be provided with adequate information to make their superannuation investment choice.

The third and final reason I briefly touch on is that this kind of legislation we are proposing has a precedent overseas. The precedent comes from the United Kingdom where an exact replica of the disclosure I have proposed has been incorporated in relation to UK pension funds, which is the equivalent of Australian superannuation funds. The disclosure requirement has been included in the UK Pensions Act. If there were copyright rules in place in relation to legislation, I probably would have breached it, because it is a word for word copy of the UK disclosure requirement. It has been in force there for one year; it is a reflection of the growing trend in ethical investment in that country. I propose that we should have a similar requirement in this country, as does a very reputable organisation, namely, the Environment Protection Authority of Victoria, who recently went to the United Kingdom to investigate the effects of this ethical disclosure requirement on the financial institutions there. I refer you to a letter in the package I have given to you from Robert Joy, the Executive Director of the EPA Victoria, and if I may quote from that letter directly:

In November 2000, an EPA Victoria officer visited key SRI participants in Europe—

‘SRI’ is another word for ‘ethical investment’

including the UK. This was done to observe developments in the SRI industry.

Although only recently enacted, it is clear that disclosure obligation changes to the UK Pensions Act, which are similarly worded to the ACF's proposed statement, have so far had a noticeable and positive effect. It appears that the disclosure requirements encourage pension funds to consider these issues when developing their investment policies. It also seems to ensure that pension fund members are better informed about the basis on which their money is invested.

In summary, EPA Victoria's observation is that the UK disclosure requirement, provides a good example of the benefit to pension fund members and other market participants of improved publicly available information flows.

I would like to refer to further documentation that is included in the package which highlights the fact that there are a growing number of organisations that now supports the proposed ethical investment disclosure obligations that we have proposed. In the package is a list of organisations that have now written to the Australian Conservation Foundation supporting the disclosure requirements, and if you could refer to that list.

Senator CONROY—There are some truly shameless organisations listed in here, Mr Kerr.

Mr Kerr—Thank you, Senator Conroy, for that remark.

Senator CONROY—Starting with the Democrats.

Mr Kerr—On that list is a number of organisations that are very reputable, and you have just spoken to CPA and ICAA in relation to their in principle support, but a number of organisations have given their full and thorough support to the ACF proposal. Included amongst them is the New South Wales EPA, and I wish to read from their letter, which is also included in the package. This letter is from Lisa Corbyn, who is the director-general of New South Wales EPA:

As we understand it, your—

meaning ACF—

proposal does not require the application of any particular investment philosophy by fund managers, merely the *reporting* of any selected approach. The EPA understands that disclosure requirements such as you propose have been implemented in the United Kingdom and that they proved influential without imposing significant compliance costs. The EPA also notes the strong increasing demand for ethical investment products in Australia and their potential to improve overall environmental outcomes.

On this basis, the NSW EPA would support in principle, regulated disclosures to consumers of investment type products to ensure that they are provided with relevant details of environmental matters (if any) relevant to the product.

The New South Wales EPA letter raises a very important point; that is, disclosure is not onerous. We are not telling financial institutions that they need to have an ethical investment product; we are merely asking them to disclose to the consumer that they have ethical credentials attached to their products. It is then up to the consumer to make their mind up whether it meets the environmental, social or ethical credentials that they may have.

I refer finally to the letter from Westpac. Westpac is a mainstream financial institution that manages $18.2 billion, they state in their letter. It certainly is a reflection that if you have a mainstream financial institution such as Westpac coming out and supporting this, obviously they have had their lawyers et cetera, look at this thoroughly. It imposes no onerous obligations on the financial institution concerned. They merely have to disclose, as I say, details of a

statement along the lines we have proposed. It is not onerous; they merely have to disclose what they are already doing. On that note, I would say it is fair and it provides consumers with extra information upon which they can make a very well thought-out investment decision. Thank you.

CHAIRMAN—Thank you, Mr Kerr. Can I clarify, I understand from reading your submission that this amendment is only to apply to advice in relation to collective investments, not, for instance, to advice on individual share portfolio investment.

Mr Kerr—Yes, it would only apply to investment-type products. It would not apply to general insurance products where there is no fund manager in charge of the investment money.

CHAIRMAN—As I read it, it applies to collective investments; it does not apply if someone is just giving you advice about a particular company in which you might be interested in buying shares.

Mr Kerr—That is correct.

CHAIRMAN—Why the distinction between purchasing shares in an individual company as against a collective investment?

Mr Kerr—The distinction is that it is probably more important with the types of products that I have outlined. A fund manager is in charge of the particular funds. When it comes to an individual's share portfolio, that person exercises the degree of control that a person investing in a managed investment fund does not have. That is why we have drawn that distinction and suggested it only apply to those types of products.

Senator GIBSON—Mr Kerr, I have great difficulty about taking on board your recommendation, and it largely derives from how you define 'ethical'. Let me take you through one example I have been thinking about. If an investment fund is trying to get people to invest in growing products and processing products that are grown in, say, the Murray Valley or the Murrumbidgee irrigation area—as we all know, a whole range of products are grown in those areas and processed on site—I can hear some members of your organisation saying that is unethical being involved in anything that is grown from irrigation waters because we should let the Murray and the Murrumbidgee return to its natural state. How do we get over this definition problem?

Mr Kerr—I do not think that there needs to be any definition. You should not define ethics.

Senator GIBSON—If that is the case, why are we doing this? It seems to me that your proposition is really a marketing one that someone is trying to put a slant on their marketing of their collective investment, and they are free to do that now. Why should we, as legislators, incorporate into law something that cannot be readily defined?

Mr Kerr—Firstly, what we are proposing also has a very carefully thought-out two or three words in there: 'if any.' So if there are no ethical considerations taken in relation to the investment product, that has to be disclosed also. Secondly, in relation to the definitional problem, it is up to the community to decide what is ethical against their own criteria. The financial institution would decide to disclose issues that it would consider come under the

banner of ethical, but again, whether the community considers that to be meeting their particular ethical criteria—

Senator GIBSON—That gets back to my point. What you are talking about is a marketing slant for particular groups or individual collective investments. No problem, you are free to do that. But what we are talking about is legislation which is wanting to set the base rules, not everything, so that investors are not misled. Because there is investment, the rules are about investment. If we cannot define some extra dimensions which you are talking about, we cannot legislate for it.

Mr Kerr—I did not say that we cannot define it; I said that I do not think that we should. But if you would like to define it, I have a perfectly reasonable definition, and that is that 'ethical' would encompass anything that is not purely a financial consideration.

Senator GIBSON—I do not think that helps.

CHAIRMAN—Following on from that, isn't the decision about what is and what is not ethical the decision of the individual investor, their view of what is ethical? Therefore, aren't they going to be able to determine that by the information that is already provided in the disclosure statement about the activities of the company? So they can make a judgement on that without that mandatory additional disclosure being required.

Mr Kerr—This specific disclosure requirement, again, like I stated before, is also to ensure that organisations or financial institutions that do not have environmental, social or ethical credentials against their products disclose that as well. Again, it is up to the consumer to establish whether that particular product meets their own criteria as to what ethical is under their definition.

CHAIRMAN—It depends on the investor. According to my personal ethics, I would never invest in, for instance, Tabcorp.

Mr Kerr—That is right.

CHAIRMAN—But others might have no objection to that from their ethical point of view.

Mr Kerr—Exactly, that is the whole point, because if there is a financial institution that has a product that does invest in Tabcorp but does not invest in tobacco companies they would disclose that that is the case and then, based on your ethical standards, you would choose not to invest in that product. Again, it is up to the consumer to make their own mind up as to what ethics is against their own criteria.

On the subject of definition, I always find it difficult whenever we propose environmental, social or ethical disclosure requirements in legislation—the definition problem always comes up. There is no definitional problem in relation to environmental or social. Perhaps Senator Gibson explained that there could be one against ethical, which I chose to disagree with.

Senator GIBSON—I could mount the same or a parallel case with regard to my examples of growing things in the irrigation areas with regard to the environmental heading. As I said, peo-

ple from your organisation, some of them, would say, ‘We should stop irrigating and return those rivers to their natural state.’

Mr Kerr—Again, if the financial institution had a policy of not investing in companies that grew crops in the Murray Darling, they would disclose that.

Senator GIBSON—I am perfectly happy with that; that is fine. But what I do not agree with is that the law should be such as to force disclosure. If people want to market that way and want to give further details about they are doing and why, they are perfectly free to do so.

Mr Kerr—That is right. Another suggestion could also be for ASIC to develop a practice note in relation to—

Senator CONROY—Let’s not give them a licence to define ethics.

Mr Kerr—I would prefer that it were not defined, because these are issues that society has embraced and is in a position now to define itself. We could also look to the United Kingdom for how they have overcome these problems as well.

Senator CONROY—I wanted to raise with you why you are going down this path rather than copying the same path as the UK—in other words, trying to say get this into the SIS legislation or getting it put through the Corporations Law to encompass the super funds in some way, whatever the similar mechanism would be. Why are you going down the individual adviser route rather than that of the super funds? My concern is that what you are actually proposing, even though the words are the same, is in actual fact a much weaker potential outcome than if you went down this other path.

Mr Kerr—Our proposal is a little wider than the UK one; it applies to other products. It also, like you say, is to be incorporated in the product disclosure statement whereas the trustee has to disclose the information at the advisory stage, as I understand it. Given that we are in the process of investigating uniform disclosure requirements, I thought it was an appropriate time to incorporate the disclosure. The product disclosure statement is the statement that is intended to provide the information to the consumer.

Senator CONROY—What I am trying to get to is that the super fund has to have a statement of investment principles and then when they tender for their business they say, ‘You have got to comply with our investment principles.’ That is the way it is having a very positive effect, so you are able to define something through your investment principles. You have heard discussion that there is going to be three statements and God knows how many pages per statement, whereas a set of investment principles would be a stronger way to achieve what you are trying to achieve.

Mr Kerr—If it were found that there was a stronger way to implement this kind of disclosure, I would be open to it. I merely saw this as an opportunity and the one that presented itself at that particular time. I would be welcome to suggestions and all ears.

CHAIRMAN—Thank you very much, Mr Kerr, for appearing before the committee and for the evidence you have given to us.

Committee adjourned at 3.15 p.m.