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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Wednesday, 13 June 2001

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

Senators and members in attendance: Senators Conroy, Cooney, Chapman, Gibson and Murray and Ms Julie Bishop and Mr Rudd

Terms of reference for the inquiry:

Financial Services Reform Bill 2001

WITNESSES

Committee met at 9.02 a.m.

CHAIRMAN—This is the second 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 2001. 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 resolved to extend the receipt of submissions until Monday, 7 May 2001. Late submissions are, however, still being accepted. The committee agreed in April 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 proceeding, perhaps I should indicate that I have received a letter from the Minister for Financial Services and Regulation regarding the introduction into parliament on 4 June of the Financial Services Reform (Consequential Provisions) Bill, the Corporations (Compensation Arrangements Levies) Bill, the Corporations (National Guarantee Fund Levies) Amendment Bill and the Corporations (Fees) Amendment Bill, which by and large deal with the transition arrangements to the new regime under the Financial Services Reform Bill and also a note with regard to media licensing under the FSRB. I suggest the committee receive that correspondence.

Before we commence taking evidence, may I reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to the 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 or 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 now welcome our first witnesses.

CONNOLLY, Mr Chris, Director, Financial Services Consumer Policy Centre

HAJAJ, Mr Khaldoun, Director of Research, Financial Services Consumer Policy Centre

PETSCHLER, Ms Louise, Senior Policy Officer, Financial Services, Australian Consumers Association

CHAIRMAN—Welcome. I invite you to make an opening statement, and at the conclusion of that we will ask questions.

Ms Petschler—We thank the committee for the opportunity to provide submissions on the legislation and to appear today to provide some more detail on some of our concerns and comments on the bill. As the committee would be aware, you have received separate submissions from a range of consumer groups but there are some common themes and some common concerns that we are hoping to provide some more detail on today. There have been a number of recent developments since we provided our submissions on the legislation which we would also like to comment on. We have some additional concerns in relation to implementation of FSR that we would like to speak about today as well. They are primarily concerned with getting the disclosure regime right and making sure that the purpose of the legislation is supported by adequate tools and infrastructure to deliver that comparability and clarity of information for consumers, and ensuring that the general advice provisions apply broadly enough to financial services to ensure that consumers get the protection and benefits of the additional training and competency requirements across-the-board.

We note that there will probably be some evidence today that may contest some of our suggestions and comments, and we are more than happy to provide supplementary submissions on those issues if the committee would find that useful. I will hand over to Mr Connolly to run through some recent developments, and then we will return to some of the key themes of concerns that have been raised in the consumer movement generally with the financial services reform legislation.

Mr Connolly—Obviously, since we made our submission on the bill, there have been some interesting developments, all of which we are very pleased with. The collapse of HIH has been followed by the announcement of a royal commission and, although we do not know the terms of reference yet, the consumer movement is very pleased that there is going to be an independent inquiry into that issue, into APRA, and also that there is some acknowledgment that superannuation will be included either in that inquiry or another inquiry.

We have been looking through the ASIC draft policy statements on implementation issues. We are pleased with those to date, although it is a lot of work to look at the implementation issues and to go through them in detail. There have also been some developments on alternative dispute resolution schemes. The committee will be aware that the consumer movement has joined forces to raise issues about the independence of some of those schemes. Again, it is an issue which we are very pleased has been made known to the public and we are very confident that we are going to get some useful results out of that.

The other development which we are pleased with is that the consequential amendments legislation, which the chairman has already referred to, deals with the first of our major issues with the legislation as it is currently written—that is, that the trade practices mirror provisions which we had feared would be lost in all of this law reform have, in fact, now been included in the consequential amendments provisions. So that is an issue which we raised in our submissions which, we are now happy to report, we believe has been addressed and we welcome the amendments which now provide ASIC with the same powers and penalties and limitation periods as the ACCC had available to it.

I would just like to turn to what we believe are some of the outstanding issues in the legislation. I will talk to the first three or four of these and then hand back to Louise. Our first issue is that the removal of the fairness test from the obligations on financial services licensees in section 912A of the bill came as something of a shock to consumers. The majority of the industry has lived with that fairness test for many years without complaint. The obligation is extremely weak. It begins with the words 'to the extent that it is reasonably practicable to do so'—so it is already quite a weak provision—and then it goes on to say that the new requirement is that they must act 'competently and honestly', while the old requirement was that they must 'provide services in an efficient, fair and honest way'.

Obviously, we were concerned to see fairness removed as a test. That test had been tested in the courts and it had proven to be quite useful to consumers. We were also concerned that it was not explained in the explanatory memorandum. It seemed quite a significant amendment to be made to the legislation without being mentioned in the EM, and we were concerned that there had obviously been no consultation with any of the affected stakeholders about that change. Despite our general support for the legislation, we would not like to see the fairness test removed from the legislation, and we trust that this committee will make a recommendation that the fairness test be added back to the legislation.

Our second concern is that a new provision has been inserted at section 914A which requires ASIC to consult with the Australian Prudential Regulation Authority where it is considering attaching conditions to the licence of an authorised deposit-taking institution. Obviously, the consumer movement has some concerns about the Australian Prudential Regulation Authority and the way it works with ASIC. Maybe I am understating the level of our concerns based on recent events. We are concerned that, while ASIC plays the most important role in consumer protection, another regulator with a different agenda has a veto power, thanks to this legislation, over ASIC's roles as soon as any banking activities are involved. It will not be any surprise to the committee to know that consumers have concerns about banks, and we are worried that APRA would have a veto power over ASIC.

We accept that ASIC and APRA must work closely together where banking licences are concerned, but do not accept that the amendment as it is currently worded would deliver a fair outcome, because it gives too much power to APRA to stall, delay or veto important consumer protection action that must be taken by ASIC. We would suggest that, in recognition of the announced royal commission into APRA, this is a provision that could easily be left on ice until that inquiry has concluded. It will definitely be addressed in the inquiry—and if no-one else does, we will make sure that it is addressed. It is something that could be revisited in the legislation at a later date, when the roles of ASIC and APRA are clearer and consumers again have confidence in APRA.

The next issue that we believe is still outstanding in the legislation is that, when it comes to the selling of financial services products, we do not believe the legislation goes far enough to prohibit pressure selling. Section 992A of the legislation prohibits some pressure selling, but only in face-to-face situations; there is no prohibition on telemarketing. The consumer movement has consistently, since 1996, lobbied for a prohibition on the telemarketing of superannuation products. As we move towards a greater choice of superannuation funds, we would have expected that the consumer protection and anti pressure-selling provisions would have kept up to date with those developments. We are certainly surprised that the government, which is the main champion of a choice of superannuation funds, has allowed a situation to develop where superannuation can be sold by pressure selling via the telephone. Superannuation is one of the most important assets held by consumers. It is a product which should be chosen by consumers in their own time, when they are considering those options and getting advice, et cetera, rather than their being subject to pressure sales.

The provision we would like to see there, as a minimum, is the power for ASIC to intervene if it has concerns about the telemarketing of any product and to prohibit its telemarketing. They inform us that at the moment they do not have that power, unless a consumer protection issue has been actually breached. We would prefer that, where they have concerns about pressure sales in a particular industry, they should be able to prohibit the telemarketing of those products, and superannuation is our key concern there. That has started us on our journey through the legislation, and I will now hand over to Louise.

Ms Petschler—I want to touch on a few of the issues that were raised in our submission and a couple of additional points, as well as the issues that Chris Conolly has raised. The first point we would like to address is the issue of commission disclosure on risk products and insurance products generally. We understand that some debate continues about the merit of including commissions in those product areas in the FSR regime, and we on the consumer movement side are very anxious to ensure that transparency and adequate information are given to consumers across the financial services market and that there are not exemptions provided for particular classes of products.

We are aware that the committee considered this in its last review of the exposure draft and that there were some differences between the majority and minority views there. We would like to restate for the record that we consider that commission disclosure on all products, particularly on risk based products and insurance products, is a critical issue for consumers. We are concerned that there is a push to try to get exemptions that would be to the detriment of consumers. We think that commission disclosure is a critical tool in improving transparency and raising consumer confidence in the financial market generally. While the argument is that commissions on risk products do not affect returns to consumers, we sincerely believe that the decision of agents to recommend one type of policy or one type of provider over another is influenced by commissions and can be influenced by commissions, and we are keen to make sure that consumers have adequate information to be able to assess the independence or otherwise of the advice they are receiving and to get the full information on the costs of the products that they are purchasing.

We believe that some of the arguments relating to small business and other issues on risk insurance commissions are perhaps not as valid as they could be. We think that consumers have a different expectation when they are purchasing insurance from salaried officers or through

branded outlets. It is very important that we have a consistent approach to disclosing commissions across the board in all products and not exempt some on the basis of their nature.

We are confident that insurance agents will still be able to disclose to consumers any additional services or additional value they may offer that is separate from products provided by salaried officers. They can explain how commissions affect the price of the product and whether in fact they do make that product more expensive than it would otherwise be or perhaps match the cost that it would be if the service were provided by salaried staff or other outlets. If the products are more expensive because of the commission, we think that is something that consumers really do deserve to know about.

We would like to emphasise that we think that full disclosure of all commissions, including bundled products, group products and insurance products, really is critical to having the objectives of the FSR Bill put in place and to delivering for consumers. That is a very strong recommendation. While we are confident that the legislation at the moment would provide coverage of that, we would like to see that extended to the product disclosure statements as well. We would also like to send a strong message that we do not support any moves to exempt commission disclosure in risk products generally.

We have a few other issues that we want to touch on. The proposed exemptions for declared professional bodies remain a concern for consumer groups. While we appreciate that the new bill does improve on the provisions that were in the exposure draft, we still have significant concerns about the principle of enabling declared professional bodies to take over the licensing obligations for financial providers and for services provided by professionals. I think we have referenced solicitors' mortgages in our submission, and I know that is an issue that comes up every time we refer to this. We think that that is a strong argument to suggest that the best approach is a consistent licensing regime with ASIC as the regulator. We are concerned that we may create different tiers of consumer protection and problems for consumers if we allow that provision to go through.

We are also concerned with the provision in section 917D concerning an exemption for the liability of licensee for representatives who disclose that they are acting outside their authority. We are concerned that this may create potential consumer protection problems. While we appreciate that the basis of the provision may be to try to enable agents or providers who offer products that are not financial services or services that do not relate to the coverage of the bill to clear up liability back to licensees, we are concerned that potentially it creates a number of problems. We would like to see that addressed by clarifying that the exemption for liability to the licensee only applies in instances where it is not a financial services product that is provided, so that it is quite clear that anything that you offer that is covered by the bill has to have liability back to the licensee and that those competency requirements have to be in place.

If that is not the case, we think some much more serious work needs to go into the form of disclosure that would be given to consumers at that point of sale. For example, you may have a situation where a consumer is sitting in an office with the AMP man, receiving advice or purchasing services. Our concern is that, in that context with this provision at the moment, that agent may be able to say, for example, 'Look, I am not supposed to tell you about this. It is actually outside my authority, but this is a great deal.' We are concerned that the consumer in that situation, sitting there with the expectation that liability will go back to, for example, the

AMP in this hypothetical case will not have that protection, and that consumers will not be across the broad provisions of the Financial Services Reform Bill or the way that those liability provisions operate and will not appreciate the importance of that disclosure. If that provision—which we are opposed to—remains, we would like to see some very clear direction given on the form of disclosure that should be given to consumers, breaking apart any product that is sold that is not within the authority of the agent and ensuring that the consumer gets a very clear message about the risks they are running if they do accept that advice and do accept that recommendation.

We are also concerned with a couple of other points, including the definition of retail client and the potential for the proposed product value test that the explanatory memorandum proposes, of $500,000, to be perhaps too low in instances where consumers receive lump sum superannuation payments. We think that setting the product value test at that level will potentially leave a large number of novice investors without the protections that the Financial Services Reform Bill is going to put in place for them, and they are exactly the sort of people who are open to misselling and poor advice and who are the target of providers who may not seek to uphold the objectives of the legislation. We note that that issue has also been raised by ASFA. We would strongly encourage the government to consider setting that product value test level at a rate that would be consistent with a higher level that would enable most people who received lump sum superannuation payments to be covered by the protections of the Financial Services Reform Bill.

We have just a couple of a additional issues that relate not so much to the legislation itself but to the interpretation of ASIC's policy proposal papers and some contentious issues that have emerged I think as industry and consumer groups and the regulators themselves are grappling with the compliance and implementation issues. There are a couple of points we just want to make quite briefly. The first one—and this I guess relates to the exemptions provided to basic deposit products and clerk and cashier work—is that there appears to be a move or some lobbying around getting broad classes of employees or services exempted from the general advice provisions in the legislation.

We would like to see consistent training and competency requirements across the board. We are concerned that we may see a situation where call centre staff or teller staff, who are the face-to-face service providers for consumers in a majority of financial services areas, may be successful in getting relief from the training and competency requirements that would attach if they were considered to be providing general advice. We would like to encourage the committee to send a strong message that, for the FSR regime to be successful, we cannot afford to exempt these large classes of direct sales and face-to-face contact that consumers have in financial services.

We think that ASIC's interim policy statement 146 on training and competency, which is one of the most contentious issues in this debate at the moment, already provides a two-tier level of training that would enable those staff, who provide those sort of services in general advice, not personal advice, to receive a lower level of training, but one that would provide adequate competencies for the sort of advice and the sort of direction that they are giving consumers. We think that goes to the heart of the financial services objectives and the aims of the bill.

We are also concerned that one of the objectives of the legislation, and one we strongly support, is improving the form of information and the comparability of information that is provided to consumers in financial services. At the heart of that are the disclosure requirements in financial services guides, statements of advice and product disclosure statements. We are concerned that we may have a situation where the legislative purpose would be defeated if we do not establish a strong enough regime that enables some prescription and some guidance to be given to industry on issues such as the dollar amount disclosure on fees and commissions and some standard terms in the way that disclosure documents are provided, to enable consumers to find the same type of information on the same type of products across different areas in financial services.

We are strongly supportive of ASIC's proposal, for example, to have consumer testing of disclosure documents as part of a compliance regime for industry. We understand that is proving somewhat of a contentious issue. We are keen to see some standardised terms; for example, standardised MERs would be a huge boost in the market at the moment. We would like to encourage the government, and the committee, to consider the importance of enabling ASIC and ensuring that the regulations provide some prescription and some guidance to industry, so that, rather than just having objectives of improved clarity and comparability, that will actually happen. We support flexibility and innovation but we see a marketplace that is increasingly complicated. Consumers are worn out by complexity fatigue, we have low financial literacy and we think it is critical that, if FSR disclosure requirements and objectives are to be met, there is very strong guidance given to industry on the format and disclosure of that information.

I have two other additional points. Firstly, we are still grappling with the transitional arrangements in the legislation but we would like to send a message, from consumer groups generally, that we would strongly encourage the conduct and competency requirements of the Financial Services Reform Bill to apply to as many providers as possible in as short a time as possible. We would not want to see a situation, for example, where life agents may have two years before they are required to comply with conduct requirements under the legislation. We are very keen to encourage industry and encourage the regulators to get as many providers as possible complying with the FSR regime as quickly as possible. Our final point relates to an issue that the Australian Consumers Association is looking into at the moment—the issue of investment seminars, gearing strategies and property consultants in the marketplace generally. I think we have long lost the battle to have investment lending, and those forms of financial services, included explicitly in the Financial Services Reform Bill. While the consumer protection provisions that ASIC has in its act will apply, we think that those areas are really expanding businesses in the Australian marketplace; they are being very aggressively sold to consumers, and we would encourage the committee, and the government, to consider the need for catching those, eventually, under the same requirements as we have for other financial services providers.

In summary, our message is that we are strongly supportive of the objectives of the bill. We think there are a number of areas where additional amendments are required and where, particularly on pressure selling, we do need to see improvements on the provisions in the bill. Our concern is that we want to see the Financial Services Reform Bill, and the many years of work that have gone into this process, really delivering for consumers a better marketplace, a better informed marketplace, and a marketplace that can be confident in the training and competency of financial services providers and have a tie back to liability for providers in that

market. We are keen to see that happen and we would very much welcome the committee's directions on regulations, and ASIC policy statements as well, to support that work to make sure that consumers get a better deal out of financial services reform.

CHAIRMAN—Thank you very much. I note your reference to the disclosure of commissions, and particularly in relation to the issue of non-accumulation or non-investment products, which has been an area of some concern. We have had submissions to the effect that the practical effect of commission disclosure for non-investment products will be to give further control over the distribution of products to the product manufacturers and, in fact, ultimately result in a declining level of service to consumers. In effect, it will result in a standardisation of commissions, and the ultimate effect of that will be to reduce the level of service provided by agents to consumers. What is your response to that?

Ms Petschler—We start from the principle that really we need to have transparency in the marketplace. We hope that issues of greater market control or market dominance are separate matters that need to be addressed through different regulatory structures and the intervention of regulators in the market. But we cannot have a situation where consumers get adequate commission information on a range of other products but not, for example, on insurance products or on non-investment products. We are confident that, if we do get that commission disclosure, then in fact we will see perhaps more competition in the market, we will see consumers getting a better deal and, at the very least, we will see consumers being told exactly where the payments are going and where the benefits may accrue to people who are selling those products. We are confident that the agents themselves will be able to explain the impact of those commissions to consumers, and whatever additional services they offer, as a result of their independent status.

CHAIRMAN—Any questions, Senator Conroy?

Senator CONROY—One of the obligations of a licensee is that they have internal and external dispute resolution procedures. What is your experience of how those procedures—in particular the external complaints boards and panels—have operated?

Mr Connolly—The starting point for that is to acknowledge that the alternative dispute resolution procedures as they were set up were supported by the consumer movement, in that we wanted consumers to have cheap alternative access to complaints mechanisms because the cost of going to court had risen so dramatically and the delays were so long. So the consumer movement has always been behind moves to introduce alternative dispute resolution, which is now a requirement of every licence.

However, having said that, the consumer movement has also been extremely concerned that the benchmarks for these ADR schemes which were issued by the government were met. One of the main benchmarks is a test of independence. It is no secret that since 1999 the consumer movement together has been involved in a dispute with the schemes, the minister, the regulator, et cetera, about whether or not these schemes are actually independent. Our concerns are that the benchmarks state that consumer representatives should be appointed to the schemes in order to ensure independence. While that happened up until 1999, since that time the appointments to the specific schemes in financial services have been inappropriate, and the people appointed have not been consumer representatives and have not been people who have the confidence of

the consumer movement, as required by the benchmarks. Those appointments have in fact undermined confidence in the schemes. Obviously we are extremely happy that that issue has now made it into the public arena after trying to resolve this behind closed doors for two years. I think it is good that the public now knows the truth about the schemes and about their independence.

I think it is important at this time of something of a crisis of confidence in insurance to note that the two schemes that the consumer movement now recommends that consumers do not go to are the two insurance schemes. Having said that, we are confident that there is now reform under way in this area and that in the medium term we are looking at a very positive response which will return integrity and independence to those schemes. We have very good support from industry on this issue now, although we have lacked that support in the past. We believe that our actions over the past two weeks by the entire consumer movement acting together have ensured that the integrity and independence of these schemes have been saved just in time and that we will see positive reforms in those schemes in time for the new legislation to go through.

Ms Petschler—I would add that ASIC have just released their policy proposal paper on ADR schemes. We are confident that the directions that they are giving there will also support our arguments for independent consumer representatives being appointed to those schemes and improving the operation of those schemes for consumers. I note that it is not in all financial services complaints schemes that we have this problem: for example, the banking ombudsman scheme has managed to appoint very effective consumer representatives through advertising and merit based appointments to that scheme. We think that model has a lot going for it.

Senator CONROY—You do not think that Bob Baldwin, the former Liberal member; Tony Issa, a Liberal Party councillor from Parramatta; and surely Mr Duffield, a former staffer of Mr Hockey's, will be able to bring all that consumer expertise? After all, they are consumers.

Mr Connolly—The consumer movement is on the record as having a complaint about both the process in which the people you have mentioned were appointed and some others, in that there was no process. There was no advertising, there was no opportunity for an ordinary consumer or someone who has consumer expertise—

Senator CONROY—Mr Hockey said on radio the other day that they are his representatives.

Mr Connolly—I think that if anyone cares to read section 12FA of the ASIC Act or the *Policy Statement 139: Approval of external complaints resolution schemes*, which was issued by ASIC, they will find that they both clearly state that independence will be achieved on the schemes by consumer representatives being appointed. It says that the minister shall appoint consumer representatives. The history of that is that the consumer movement actually asked the minister to take a role in making the appointments, because the alternative at the time was that the industry would make the appointments. However, every previous minister has appointed representatives on a merits based test based on the benchmarks after national advertising. There is no evidence anywhere that these representatives are supposed to represent the minister or government policy. Apart from the minister's statements, there is no-one in industry, the consumer movement, the regulators or the schemes themselves who supports the view that these people are supposed to represent the government. They are supposed to represent consumers.

Senator CONROY—I understand that ASIC was rumoured to be considering the appointments and representations that you have been making on these issues. Is that the case?

Mr Connolly—ASIC has been involved in this issue since 1999, to my knowledge, and has made other attempts to improve the independence of the schemes. We are confident that its latest shot at this particular reform will succeed. The actual details of ASIC's action in this area are not for us to talk about. ASIC intends to reveal those in due course.

Senator CONROY—Have ASIC finalised their consideration of these issues that you have raised?

Mr Connolly—ASIC received the formal complaint on Thursday. We would be surprised if there were any—

Senator CONROY—I understand that it was in the newspapers yesterday and that the minister was on telly saying that he has been investigated by ASIC and cleared. Have you received notification from ASIC yet that that is the case?

Mr Connolly—Our understanding—and we have been in close contact with ASIC; in fact, we have a meeting scheduled with them later this week—is that ASIC have embarked on a course of action which we are quite happy with, but they will reveal their actions in due course.

Senator CONROY—But they have not met with you yet to even talk to you about the complaint?

Mr Connolly—We have had one telephone link-up and we are meeting again on Friday.

Senator CONROY—It would seem unusual, if they are meeting with your later this week, if they had already finalised and completed their investigation and cleared the minister.

Ms JULIE BISHOP—Perhaps ASIC can give their own—

Senator CONROY—Hopefully they will be here to do that tomorrow.

Mr Connolly—The short answer is that I presumably would have heard if our complaint had been dismissed. The only signals we have had have been to the opposite effect.

Senator CONROY—So ASIC have not advised you that they have cleared the minister?

Mr Connolly—Absolutely.

Senator CONROY—Your submission states that the consumer protection provisions in the ASIC Act, which were transferred from the Trade Practices Act, no longer mirror the corresponding provisions in the Trade Practices Act. Do you know why the ASIC Act has not been amended in line with the amendments of the Trade Practices Act?

Mr Connolly—Obviously that was of very serious concern to the consumer movement. However, as I have noted in my opening submission—

Senator CONROY—Sorry, I missed your opening submission, unfortunately.

Mr Connolly—We are very pleased that the consequential amendments address our submission on that point.

Senator CONROY—I know that you and Ms Petschler mentioned the question of the obligation of licensees to act competently and honestly, replacing the existing obligation, which is to act in an efficient, fair and honest way. What do you think would be the effect of that change—of the requirement to act in a certain way only to the extent that it is reasonably practicable to do so?

Mr Connolly—Our advice is that the removal of fairness removes one of the aspects of a test which had been used in previous court cases to argue that there was a requirement on advisers to act ethically. Obviously the last thing that consumers want is for a requirement to act ethically to be removed from the legislation. It is also in keeping with the objectives of the act. One of the key objectives of the act is to ensure, in the words of the legislation, fairness, honesty and professionalism by those who provide financial services. The objective has not changed, so we are not sure why that particular clause, 912A, has changed and removed fairness. There is certainly an inconsistency between an act which has an objective of fairness but which removes a fairness obligation on the people who actually carry out the provision of advice and services in financial services.

Ms Petschler—We are also concerned with the qualification generally. It may not always be practicable to act fairly, efficiency and honestly, or even competently and honestly, if that may damage financial returns for an institution. We think it would be better to be very clear in the legislation and be consistent with its objectives and return that fairness and honesty.

Senator CONROY—Have you had any chance to get any advice as to what 'reasonably practicable' would cover?

Ms Petschler—We are still unclear and we are not alone in that. Our sense is that even the major law firms that are looking at this issue remain concerned about the potential implications of that point.

Senator CONROY—Could this be described as the 'get out of jail free' card?

Ms Petschler—It does concern us that it is a fairly broad qualification and we are not sure what the motivation for that was.

Mr Connolly—If a consumer had to challenge that matter in court, obviously the power imbalance comes into play. If we are talking about a major financial institution relying on watering down the obligation to just where it is reasonably practicable, it is going to be a very expensive exercise for an individual consumer to argue that it was not reasonably practicable. That is one of the problems when you introduce those watering down clauses into this type of legislation. You remove certainty from the relationship between business and consumer, and any

removal of certainty just emphasises the other power imbalances which exist between consumers and business.

Senator CONROY—You mention in the ACA submission that ASIC's power to cancel and suspend licensees and representatives has been watered down. Can you expand on that?

Ms Petschler—That is a concern we have generally across the bill. I guess it relates as well to their capacity to pre-empt or to act where they feel that a licensee or an authorised representative may be likely to act in a way that would be to the detriment of consumers. We have had some difficulty in following through the enforcement provisions sufficiently to be confident that ASIC would retain that power. We have had discussions with ASIC on that point and they seem to share some of those concerns. We would like to see the regulator being able to act on the basis of evidence that a provider may be likely to breach the obligations of the legislation. We are not sure that the amendments actually enable ASIC to do that, and we think that that is quite an important point.

Senator CONROY—You have also expressed concern that the prohibition on cold calling has not gone far enough. What do you think is necessary and what evidence do you have to suggest cold calling is a significant problem requiring legislative response?

Ms Petschler—Our concern with the pressure selling provisions in the legislation are that really they are just limited to face-to-face sales. While that is very important and has been a focus of the consumer movement for a long time in providing additional protections, in door-to-door sales in particular, we have seen an expansion in the market of telemarketing, direct selling over the Internet, spam sales and a whole range of areas where consumers face a barrage of pressure selling techniques. We would prefer that the regulators have the power to step into the market in instances where misselling or problems with selling practices occur. At the moment the legislation really only gives them that power in terms of face-to-face sales. If you turn to the ASIC web site, for example, you will see a range of consumer alerts about different direct selling practices, including telemarketing of domestic or international schemes, investment programs, spam emails and Internet sales generally. Under this legislation they will not have the additional power to step in and provide guidance to providers in that market and to have the additional powers that that provision gives. We would very much welcome extending that. Given that ASIC has wide powers there to step out of that market as well, and the provision gives ASIC the power to set the rules up to come in as needed, we think that that is an appropriate power to give them in telemarketing and direct selling generally.

Mr Connolly—The committee might be interested to make some inquiries with the Banking Industry Ombudsman about complaints he has been receiving about the telemarketing of life insurance products by banks, including one complaint that the bank staff involved telemarketed a household, did not speak to a bank customer but instead spoke to another member of their family, talked them into getting a life insurance product for the person who was not home and even then arranged to debit the premiums from that person's bank account without ever having spoken to the individual bank customer. There is so much pressure in that telemarketing situation—both on the salesperson to make a sale and get a commission and on the person at the end of the phone to get the seller off the phone so that they can go and get on with their life—that all sorts of ridiculous situations like the one I have described can occur. It would be

interesting perhaps for the committee to make some inquiries about what the banking ombudsman is seeing in telemarketing.

Senator CONROY—I think ASIC have drawn to the attention of some of the committees that I have been on, and probably through their web site, overseas companies phoning in with some fairly unsavoury practices. If ASIC are alerting Australian consumers to the overseas companies, do you think it is fair that they are not alerting people to the domestic situations which are similar?

Mr Connolly—We are not asking for ASIC to automatically ban the telemarketing of all financial services products. I think that a particular company could go to ASIC and say, 'Look, here are all the protection mechanisms we have got in place. This is exactly what we are going to do and we are not going to waver from this at all,' and it might be that ASIC could approve telemarketing in certain limited situations. Our understanding is that they do that. However, ASIC is now left without the power to intervene at all in the telemarketing of financial services. So our preferred position as set out in the submission is for superannuation to have complete prohibition and, in all other products, ASIC to have the power to intervene.

Senator CONROY—You have expressed concern about the exemption for declared professional bodies. Could you expand on that a little?

Ms Petschler—Our concern is that the legislation establishes what is intended to be a consistent licensing regime across financial services. We think that people who are providing financial advice or financial services should be covered by the same obligations and regulated by the same entity. We are concerned that the professional body exemptions may enable certain classes of professionals—for example, accountants and lawyers in particular—to provide financial services without ASIC necessarily having the power it needs to license and monitor those providers. While we appreciate that the legislation has improved on the exposure draft in a number of areas and it has cleared up some of those concerns, I think in general it is a concept we do not support. I think if we are having a consistent licensing regime and if we are having consistent obligations across financial services, then we really do need to have ASIC as the regulator in those instances and give it the power to ensure that consistency across the board.

As I mentioned, we do have doubts about the capacity of professional bodies to be able to adequately enforce the legislation. They have a conflict of interest in a sense. You cannot expect professional bodies to be expelling members or taking action on members when in fact often they are a lobbying organisation for their members for advancing their interests and for protecting them from adverse regulatory outcomes. So I think there is a potential conflict there. We think it would be much simpler and much more in line with the objectives of the legislation if that provision were removed.

Senator CONROY—In another committee that I and Senator Chapman have been on, we have been hearing some fairly disturbing evidence about some of the solicitor mortgage schemes around the country. Do you think that the legislation that we have here, in the way it allows declared professional bodies, would actually stop a recurrence of the sort of things that have gone on in Western Australia and in Tasmania, which have got the most publicity although I am sure there are other problems?

Ms Petschler—Our view is that the disastrous outcomes for consumers from those schemes are reason enough to prevent any opportunity for a similar occurrence. We are not confident that any exemption that cedes licensing responsibility back to professional bodies is in fact the best way to go forward. We are not confident that this bill would protect consumers from those outcomes in the future. I think it would be an expensive and resource intensive process for both the regulator and the professional bodies themselves to adequately maintain FSR standards for their members. We are not confident they could do that successfully and we think it would be preferable from the consumers' point of view to have ASIC as the regulator rather than providing those professional organisations with that responsibility.

Senator CONROY—I guess, to use an analogy of an organisation close to my heart, it would be like asking the TWU to be in charge of policing the road rules about, say, how much a truck can carry and then expelling its members if they found anyone carrying an amount more than the prescribed regulation.

Ms Petschler—That is exactly the sort of conflict of interest that we think would affect the ability of those professional bodies to adequately enforce the legislation.

Senator CONROY—Have you received any guidance from Treasury as to what is contemplated by work ordinarily done by clerks and cashiers yet? Are we making any progress on this at all?

Ms Petschler—We have not received any guidance on that matter. We remain concerned that, with such a potentially broad exemption, it ties back to our point about who is covered by general advice provisions and the capacity for industry to perhaps expand the definition of work ordinarily done by clerks and cashiers to include a wider variety of people who are engaged in selling to consumers. That would subvert the aims of the bill and the aims of the government in this legislation.

Senator CONROY—Just on a matter that you have not covered in your submission: the committee has received a submission from Fairfax and News Ltd regarding the removal of the exemption for financial journalists from needing an investment adviser's licence—that is the exemption in section 77(6). Do you have any knowledge of consumers suffering unjustified loss because of the current exemption?

Ms Petschler—No, we are not aware of any specific examples.

Senator CONROY—I opened up the paper on the weekend and there was investment advice from a financial journalist saying, 'Look, here are my recommended three picks.' Do you think there is a problem in those circumstances? Do you think there is enough 'buyer beware'?

Ms Petschler—I think there is a tension in wanting to improve the information out there for consumers. I think financial journalists and those personal advice columns play a very important role, and *Choice* magazine itself we think plays quite an important role, in providing that sort of advice to consumers. But there are issues where consumers potentially are misled where there currently may be abuses of the exemption. I think we will see that increasingly, in terms of online media and online provision. That is an issue that I understand ASIC is having quite detailed negotiations with journalists and the press about; it is raised in their policy

proposal papers, and it is something that we are grappling with as well. We can see the need to enable journalists and the press to continue to perform that function. But we see a need and want to make sure that, with things like newsletters, online sites and potentially where journalists stray into areas that in some instances are considered to be the giving of quite personal advice, the appropriate protections are in place.

Senator CONROY—Will *Choice* magazine be captured, do you think? Where are you at with your own publication?

Ms Petschler—We are grappling with that issue at the Australian Consumers Association.

Senator CONROY—Are you demanding that you be regulated?

Ms Petschler—The issue is probably related more to our online services than to the magazine itself; that, as you know, focuses mostly on very general comments and tips for consumers.

Senator CONROY—So you are more likely to be captured, given that it is a sort of online situation.

Ms Petschler—It will depend on our calculators and whether some of the tips we give consumers might stray into that area. If that is the case, of course we will comply with the legislation, which we have lobbied for.

Senator CONROY—The bill has also introduced a requirement that telephone conversations between the bidder or target and shareholders in a takeover be recorded. We do not know where this amendment came from. Has any shareholder ever complained to any of your organisations of any misconduct in this area?

Ms Petschler—Not recently that I am aware of.

Mr Connolly—No, I am not aware of that.

Ms JULIE BISHOP—Just on the second last point about the media exemption, does it then come down to a question of what is 'personal advice'?

Ms Petschler—I think broadly it comes down to general and personal advice and whether there should be broad exemptions or not. I think the ASIC PPPs on it propose a couple of examples of advice that they think would be appropriate and that which they think would not be. I think that is an issue that is quite complicated and it is something that ASIC, as the implementation body for FSR in a lot of ways, really has to get across. We will be very interested in following that through. As I say, we do not want to stop information being in the press that helps consumers. In an environment where we do not have a very well funded financial education strategy, I think that really is quite critical. But we are seeing an increase in things like online sites that purport to offer independent advice or comment. We are seeing increasing chat room problems. We are seeing newsletters in the market that perhaps may be misleading consumers or where there needs to be better disclosure. So we will get some of those issues addressed.

Ms JULIE BISHOP—And then potentially the impact of datacasting on that sort of arrangement?

Ms Petschler—Yes, I guess that is probably so.

Mr Connolly—Yes. I think the legislation will obviously have to pick up the new forms of providing information to consumers, including datacasting.

Ms JULIE BISHOP—Ms Petschler, just going back to the issue of disclosure of commissions: what evidence do you have to back up your conclusion that consumers are influenced by commissions where there is no difference in the price to the consumer or where the commission paid did not affect the return?

Ms Petschler—That consumers are influenced?

Ms JULIE BISHOP—Yes.

Ms Petschler—Our point is not so much that consumers are influenced but that we really should give consumers the full picture on what they are being sold and where the benefits accrue. I think that is a fairly standard position that is inherent in the objectives of the FSR Bill. We are confident that where sales are based on commission, if those commissions are disclosed in a very clear way, the providers of those services will be able to explain to consumers how those commissions might compare with offerings by salaried officers, for example, and we are very confident in their expertise in doing that. I think we are really keen just to make sure that commission disclosure applies across the board so that, wherever you are buying in financial services, you know you are getting the full picture. That just gives you that extra tool that we do not have at the moment that would really let you assess what is going on in terms of the sales that you are getting.

Ms JULIE BISHOP—So you do not foresee any particular consequences if disclosure was not required where commission paid did not affect the return, or do you?

Ms Petschler—I think potentially the consequences are that you have a less informed market. We appreciate that agents argue that they always sell on the basis of the best provider and the best service for that consumer. But in fact anyone selling in financial services makes that argument, and it is an argument that financial planners would have made years ago when we were debating commission disclosure in that forum as well. I think really the best approach from the Australian Consumers Association's point of view is very clear information to consumers and very clear outlines of where benefits are. We are concerned that in some instances consumers may be sold more expensive policies or policies that are less appropriate on the basis of commission, and at least informing them that commission is an element in the sales decision will enable them to ask additional questions that might give them confidence that they really are getting the best product for their needs.

Ms JULIE BISHOP—Mr Connolly, you raised the issue of consumer representatives. To what organisations have you been appointed a consumer representative?

Mr Connolly—I have never applied for, expressed an interest in or been appointed to any alternative dispute resolution organisation. I sit on a couple of consulting forums. I was on ASIC's consumer advisory panel for two years, and I am on Telstra's consumer consultative committee. I am the elected chairperson of the Consumers Federation of Australia, and the consumer movement requires that the person in that position is an effective lobbyist and does not get tied up in conflicts of interest, et cetera. As I said, I have never expressed an interest in or applied for any ADR position.

Ms JULIE BISHOP—What are your particular qualifications to take on those roles?

Mr Connolly—I am the spokesperson on this issue for the entire consumer movement, which includes the legal aid, consumer credit legal centres, financial counsellors, et cetera. In 1999 four people were chosen to be spokespeople on this issue, and they were from the Australian Consumers Association, me, one from the consumer legal centre and one financial counsellor. We were chosen because we were not members of any schemes, had never applied for any schemes and were not federally funded, and we were sent off to fight on this issue. This is the culmination of a two-year argument about that, and I think it was a good decision to choose us. There is no question that any of us have any self-interest or conflict of interest here.

Ms JULIE BISHOP—Can I just go back: what are your particular qualifications to be a consumer representative or part of this organisation?

Mr Connolly—I am not asking to be a consumer representative on any scheme. I have been chosen to speak on this issue because I have worked in the community sector for 10 years, I have worked in the consumer movement for six years, I wrote the consumer response to the Wallis inquiry, I have been involved in lobbying before committees like this on financial services reform for many years and I am seen as an effective advocate on behalf of caseworkers, financial counsellors and low-income and disadvantaged consumers.

Ms JULIE BISHOP—In relation to the consumer representative appointments to which you were referring, do you agree that in making such appointments there ought to be a diversity of experience and background?

Mr Connolly—Yes. Previous ministers advertised the positions nationally; anyone could apply.

Ms JULIE BISHOP—Do you agree that a cross-section of the community ought to be considered in these appointments?

Mr Connolly—Yes, they should. That is why they should be advertised so that anyone can apply.

Ms JULIE BISHOP—Do you think it is appropriate to roll over the positions in order to ensure that there are fresh ideas injected and different approaches taken?

Mr Connolly—Most positions are capped. For example, in relation to the Banking Industry Ombudsman, it does not rely on the minister, it chooses its own positions and you cannot serve on the Banking Industry Ombudsman's scheme in any capacity for longer than five years. It has

achieved a good rotation, and it has achieved an excellent cross-section of the community through national advertising and merits based appointments. It has also managed to find people who have expertise in consumer affairs, and the people appointed to that scheme have no industry links or political links.

Ms JULIE BISHOP—Do I take it that you expect some sort of consultation with the minister of the day in these appointments?

Mr Connolly—Over the two-year period that we have been arguing on this issue, we have put up I think seven different possible models for how the appointments could be made. In the majority of those models, we suggested that there was at least some consultation with groups like ACOSS, the Australian Consumers Association, the Consumers Federation of Australia, et cetera, or consultation with the regulator. In a couple of those models, in an attempt to find a reasonable compromise, we have abandoned consultation in favour of national advertising and merits based appointments. But there is certainly no requirement on our part that the consultation would result in a veto over the minister's decision. As we note, the Banking Industry Ombudsman have appointed very effective consumer reps without involving the minister at all. They advertise nationally and they ask consumer groups to nominate people, but there is no requirement that they appoint someone who is nominated by consumer groups.

Ms JULIE BISHOP—But you would accept that, if you nominated someone, obviously the minister has a discretion to disagree or agree with your recommendation?

Mr Connolly—And they have always had that discretion.

Ms JULIE BISHOP—Have any of your policy papers ever been adopted by a political party as part of an election platform?

Mr Connolly—I have never written a political platform for a party. I have written three—

Ms JULIE BISHOP—I said any policy papers.

Mr Connolly—I will go through them. I have been involved in three research papers. In fact, two of them were cowritten with my colleague Khaldoun Hajaj. The first was on superannuation and choice of fund. It supported government policy to pursue superannuation choice and it opposed Labor Party policy.

Ms JULIE BISHOP—But I asked you specifically whether these papers have been adopted.

Mr Connolly—I will go through all three. The second was on consumer education, and it was launched by Minister Hockey. It was not party political in any way, although it did support at the time coalition government policy on consumer education. The third paper is called *Financial services and social exclusion*. It was part-funded by the Chifley Research Centre, which has links to the Labor Party. That policy was possibly influential in the Labor Party's banking policy and certainly was used by spokespeople for the Labor Party to back up their policy. In other words, the Labor Party policy was not written by me or anyone associated with our centre; it was written by the Labor Party, but the Labor Party had consulted over a two-year period with the consumer organisations. When the policy was launched, they made fair use of

the fact that our research pointed to a lot of similar problems in banking that the consumer groups had recognised for some years.

Ms JULIE BISHOP—So this was a paper that was part-funded by the Chifley Research Centre?

Mr Connolly—Yes.

Ms JULIE BISHOP—It is an attachment to the ALP banking policy?

Mr Connolly—It is.

Ms JULIE BISHOP—And it was launched by Mr Beazley?

Mr Connolly—Yes.

Ms JULIE BISHOP—You were speaking earlier about not having any conflict of interest. Do you have any concern that that gives rise to a question of impartiality in relation to someone who wrote the attachment to the ALP's banking policy?

Mr Connolly—I do not think anyone in the community would be surprised that consumer organisations, including my own, support rigorous policies on banking issues. Banking is one of the absolute top agenda items for the community and for consumer organisations. The coalition does not have a banking policy. I am quite proud of the work we did on financial services and social exclusion. But in terms of trying to make a link between that and some perceived conflict of interest that we have issues with the minister's appointment to the insurance schemes I think is drawing a long bow, especially, as I have pointed out, as one of our other papers supported the coalition policy and one of our other papers was launched by the minister himself.

Ms JULIE BISHOP—Is it an attachment to coalition policy?

Mr Connolly—Neither of those other two papers are attached to policy.

Ms JULIE BISHOP—I asked whether it raised a question of impartiality in your mind.

Mr Connolly—I think that we can assure consumers that, when we are tackling the questions of whether or not consumers should appear before the two insurance complaint schemes, of whether or not we believe that those schemes are independent or of whether or not we believe that the appointments were made appropriately or via any process at all, I am making that statement on behalf of the entire consumer movement and I can assure them that I am making that impartially.

Ms Petschler—There is an additional point on the issue of impartiality in relation to the minister's appointments to the IEC and the FICS schemes. There has been a lot of focus on Mr Connolly raising those issues and his centre being the centre that did raise those issues. The Australian Consumers Association in fact issued that press release, endorsed that complaint and has been involved, as Chris mentioned, in the ongoing process to try and achieve some reform

in these areas. We are very confident that, by the involvement of a group of seven consumer organisations in raising those issues, we felt it would reflect the serious nature of our allegations and the problems we were raising.

Ms JULIE BISHOP—I think you were quoted as saying that there needed to be real consumer representatives appointed. By real consumer representatives, do you mean—

Senator CONROY—Not the minister's next door neighbours.

Ms JULIE BISHOP—valid consumer representative appointments, being those from your consumer advocate group?

Ms Petschler—No. Occasionally my comments are reflected in the press in a way that may not be my preference.

Ms JULIE BISHOP—Join the club.

Senator CONROY—I agree with that.

Ms Petschler—The context for that comment about real consumer representatives was our concern for real people that go to these schemes. They expect to sit down before a panel with someone from industry and a consumer representative. The purpose of that representative is to balance industry views and be able to understand and appreciate the issues that the person faces so we would never see it as appropriate that ACA, for example, should be on those panels or boards. We would like to see people with casework experience or with legal experience in those areas, with an understanding of the particular issues that relate to consumers who will bring complaints forward. That was the sense I was trying to convey with the quote you mentioned.

Ms JULIE BISHOP—So you are not suggesting that consumer representative appointments come from within your consumer advocate group?

Ms Petschler—No, we are not suggesting that. As Chris has identified, we have raised a number of proposals. We are suggesting a range of strategies, including national advertising of positions, and we support merit based appointments. For example, the banking ombudsman's criteria include the capacity to be able to draw on consumer concerns in banking issues and that is a very important criterion for these sorts of positions. That is exactly what we are after: having the best people for the job there and people who really do represent the consumers' interest in that context.

Ms JULIE BISHOP—One final point: under other issues, you raised consumer testing. Can you run that past me again? What did you have in mind?

Ms Petschler—One proposal is that in drafting disclosure documents for the FSR regime, in its policy proposal papers ASIC has suggested that a useful approach for industry might be to do a bit of focus group testing or consumer testing of their actual documentation before they issue it and that that would be looked on favourably in terms of their compliance. We think that would be a very good idea. Often we have situations where disclosure documents are drafted with the focus on meeting the technical requirements of the law. Our experience, where we have

engaged in focus group work or qualitative consumer testing of disclosure documents, is that there have been some quite important recommendations come out of that, including quite simple things like table headings, tables of contents and the use of appropriate and easily understood terms. That would really benefit those documents and would be a very cost-effective way for industry to improve their disclosures regime.

Senator MURRAY—Ms Petschler, Mr Connolly, you have both emphasised throughout this discussion on appointments that you support merit based appointments. Are you aware of the 1995 Nolan report in the UK—which was adopted by the government in the UK—which agreed to set criteria for appointments; in particular, that they were based on merit?

Mr Connolly—I am not aware of that report, but I would be very interested to look at it. I guess the consumer movement actually believed that we did have a merits based test, because in 1997 the consumer affairs minister issued the benchmarks for alternative dispute resolution schemes, and they say that consumer representatives should meet two requirements. One is an understanding of consumer issues and experience in consumer affairs and the second is the confidence of the consumer movement. We thought that those two tests could be used as a merits based test to run the ruler over the applicants, if there were ever applications for these positions. But I would be very interested in that report and am pleased you mentioned it.

Senator MURRAY—Have you done any research in searching the *Hansard* to establish whether there has been any attempt to make merit based appointments part of law in this country?

Mr Connolly—I am unaware of that, but if you have any information along those lines we would be very interested in it.

Senator MURRAY—Based on the Nolan work, which was accepted by the UK government, the Democrats devised a set of amendments which included that ministers should determine criteria which should include merit based appointments. Are you aware that 17 times—the 17th time was at the last parliamentary sitting—both the Labor Party and the Liberal Party voted those amendments down?

Ms Petschler—No, I was not aware of that. I think perhaps the struggles the Democrats may have had in getting that issue forward demonstrates the importance of sometimes getting the minister out of making appointments to schemes that are as important to us as those.

Senator MURRAY—Might I recommend to your centre that you do a careful study of work on that and on the attitudes of the major parties to this issue and the arguments against merit based appointments?

Senator CONROY—Are you commissioning them to do work, Senator Murray?

Senator MURRAY—I just thought you had made some strong points, Senator Conroy, which unfortunately your party have not agreed with.

Senator CONROY—The story of my life.

Senator MURRAY—On the second, and other, issue that I wanted to pick up—because many issues have been covered—there is an excellent committee chaired by Senator Cooney called the Senate Scrutiny of Bills Committee, and that produced an outstanding report on search and entry provisions in the law. One of the things which may attract your attention is the fact that that committee recommended that, in all cases of face-to-face interaction with agencies and authorities which are exercising warrants, they should have a piece of paper which clearly, shortly and briefly expresses in writing what is being conveyed verbally. One of the great weaknesses of this kind of legislation and this kind of approach is that it relies on the individual—and there are thousands of them—to convey similar information, as required by law, to a variety of consumers. It is just not going to always be in the correct frame. So my question to you is: do you think that the legislation should require that a standard document be available which is short, brief, to the point and clearly understood and which expresses the main points that consumers should be alert to when being sold financial products?

Mr Connolly—There are certainly some requirements in the legislation for two documents to be provided—the general guide and the product information statements. I am not sure that this is an area where there is a shortage of documentation to back up the verbal advice.

Senator MURRAY—What about the Internet?

Mr Connolly—Our understanding is that, simply because you are using a different medium to sell the product, that does not allow you to avoid not providing either of the two documents required under the legislation. Having said that, obviously the consumer movement has a lot of experience in credit, where consumers are given quite a lot of documentation but might be told something completely different verbally, and that has been the subject of some fairly heated disputes in the tribunals. It might be a weakness, but there are two documents required in the legislation, and we are reasonably confident that that is enough.

Senator MURRAY—Thank you.

Senator COONEY—This is a speculative question in some ways. I would like to get from you an assessment of what this sector is like. Lawyers can make mistakes—politicians cannot, of course, but we are accused of doing so!—but is there a danger in what you are doing that you are going to regulate everything? If there is a mistake in the financial sector industry—professional, or whatever you want to call it—and you are going to rush to ASIC to cure it, what you will have in the end is a heavily regulated sector. It is a bit like somebody saying, 'We are going to go into the profession of people that look after consumers and we are going to regulate every bit of advice that they give and, if they give the wrong advice, we will get ASIC in.' That does a few things. It creates a fairly tense situation, rather than a culture where people do the right thing because that is the right thing to do. Not only that, but you are throwing suspicion on people who are mostly honourable, and you are giving lots of work to ASIC. Is ASIC competent? That is the question.

Senator MURRAY—And properly funded?

Senator COONEY—And properly funded, and all those sorts of questions. I think you know what I mean—that balance is always a problem, isn't it? Over our spaghetti and our cup of coffee we can say, 'Well, see what has happened this week, isn't that terrible'—you know the

language; not that you have ever gone through it, but you might have seen others do so. Can you give us a bit of a comment in that context?

Mr Connolly—It is always good to have that big picture discussion. We should have started with it. This is an industry where we do not regulate the products. You can design any financial products; we do not put any limits on you. You can make up a product tomorrow which is a mixture of gearing, a managed fund, some other tax-effective advantage, and includes overseas products, et cetera. There is no regulation on that. We do not regulate prices, so the industry is able to set its own price, fee and commission structure. However, we do regulate the information provided to the consumer and the selling practices. I think that is a reasonable compromise.

The products are complicated; the community is not well educated about financial services; there is a massive power imbalance between an ordinary individual consumer dealing with a major financial institution; and the purchase of these products can be vital to a person's retirement savings. I think we are actually starting with a compromise which sets the balance about right, and if the financial services industry behaves it does not become subject to very detailed regulation. But if the insurance industry keeps collapsing, and if there continue to be hundreds, thousands, tens of thousands of complaints about the financial services going through these schemes—for example, the latest figures are that there are 75,000 complaints a year just about EFTPOS, the simplest financial product on the market—then the comeback is, 'Yes, there is regulation.'

Senator COONEY—I can understand regulating the provision of information: I think there is no problem about that. The more delicate issue, and in a sense the harder one to judge, is that of selling techniques, because if you are in an industry I suppose you have got to sell your products. Who is going to make the choice about whether you have gone beyond it? Is that going to be a series of court cases—which, as I think you have already said, is a very expensive position—or is it going to be ASIC? If is going to be ASIC, who is going to judge whether it was a fair sale or not? What you might get is a whole tumble of fairly expensive procedures. Have you thought about that?

Mr Connolly—Obviously we are trying to aim—

Senator COONEY—How prevalent is it? Is the vice a very extensive one in your view or is it just here and there? What is the position?

Mr Connolly—We are trying to get consumers into a situation where it is their decision to go and consider financial services products, to get a financial plan, and they are not in a pressure situation where someone has visited them at home or in the workplace or contacted them on the telephone when they are trying to get the kids to bed et cetera. It should be their own decision to shop. We are trying to get them to shop around. I do not think there is a lot in the legislation which actually tackles selling practices apart from the ban on face-to-face selling practices which have been a major problem. Door-to-door salespeople have hit low income communities; Aboriginal communities have been hit by advisers flying into a town and signing everyone up to inappropriate products, no matter what their status is. There are good reasons why some selling practices are being tackled.

Senator COONEY—Correct me if I am wrong, but what you really want to safeguard against is the exploitation of a community weak in the sense of not being equipped with the skill and knowledge to deal with this.

Mr Connolly—It is not just the weak consumer; it is being caught in a weak moment. That is how pressure selling works.

Senator COONEY—Once you get to that, do you not get into all sorts of questions of fact which are going to lead to disputes which can be fairly expensive? Have you thought about that?

Mr Connolly—I think that there will be disputes and we hope that there are independent and appropriate people whom they can complain to. That is a requirement under the legislation, which we hope will be reformed.

Senator COONEY—That then leads you to the problem of who is going to be the independent arbitrator and what it is going to cost to go there. Do you get independent arbitrators unless they have got tenure, pensions and things like that? Have you thought about that?

Mr Connolly—There are a couple of models out there. There are ombudsman schemes and the industry complaint schemes. Overseas there has been a push for statutory ombudsmen rather than leaving it up to the industry to look after the complaints. That is something that we have not really explored in Australia yet. We are hopeful that the industry complaint schemes will succeed and can be independent and have integrity. We will not hold that hope out forever though, obviously.

Senator COONEY—It is almost a separate topic, but if you have a person who has been exploited and that is the only person, an ombudsman is the only body you would go to, but if it is as prevalent as you seem to say it is, you are going to need some sort of scheme. Unless we work out where you go to put your complaint, we are not getting terribly far, are we? If it is as prevalent as you say it is, you would probably need a whole raft of tribunals.

Ms Petschler—One of the aims of the legislation is to get those ground rules very clear and to try to address that at the front end. That is one reason why we are happy to see the end result of this process. It is an enormous market and consumers are at a disadvantage. They are being asked to take greater responsibility for managing their own investment outcomes and retirement incomes and for controlling a larger amount of money. There is an enormous amount of money to be made, not just in deliberate misselling but perhaps in confusing consumers or having a lack of clear disclosure. We are just talking about the ground rules, addressing it at the front end and hopefully that will lift standards. I do not have a sense that the industry will face over-regulation as a result of this legislation.

Senator COONEY—I am not asking about over-regulation. I am asking about who is going to enforce the regulations that are there.

Senator MURRAY—And resolve the disputes.

Senator COONEY—And resolve the disputes, as Senator Murray says. Can you follow that? You have put up a scheme and you have given us the picture that this is a very prevalent problem throughout the industry. Yet you have said only that we will have the ASIC coming in. It seems to me that if it is as prevalent as it seems to be, you are going to have to have some sort of system to enforce the regulations.

Mr Connolly—We certainly hope that that would be an effective system. The current model is built around industry complaint schemes that supposedly report to the regulator if they see any systemic misconduct. So if they see the same complaint 10 times about the same person who is supposed to report—

Senator COONEY—Can you see the problem? It is not so much the rules but it is the evidence that you have got to play with. It is the evidence of whether or not the rules have been broken. The only way that you can establish what really happened is to have some sort of tribunal or decision maker say, 'Look, this is it.' What I am saying to you is that if the problem is as prevalent as you say it is—and I am accepting that—you will have to have more than one ombudsman. You will have to have a whole raft of quasi-judicial bodies and then you would go to the courts, which would obviously be the best way of getting decisions made. But if you do that, then you are into a very expensive sort of exercise. What I would like to have from you, if I could, is some idea of how you are going to settle the disputes. The person who has taken out the policy will say, 'This is what happened.' The person selling the policy will say, 'This is what happened.' You have to decide between them in some way, and I am wondering how you are going to do that.

Mr Connolly—There are six complaint schemes now in financial services. Their standards vary. A lot of work has been done on their terms of reference to ensure that there is more equality of power between the consumer and the industry representatives. But, as you say, it is unfinished business; there is a lot of work to be done there.

CHAIRMAN—There are no further questions. I thank each of you for appearing before the committee and for your answers to our questions.

[10.33 a.m.]

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

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

VEIVERS, Mr Gregory John, Director, Life Agents Action Group

CHAIRMAN—We have before us your submission, which is numbered 4. Are there any alterations or corrections you need to make to the submission?

Mr Maughan—We do have some statistics that we want to present. We might have a preamble and present them as part of the preamble, if we could.

CHAIRMAN—That is fine. If you wish to make an opening statement, please proceed. At the conclusion of that we will have some questions.

Mr Maughan—Firstly, we would like to say that there is much in the Financial Services Reform Bill that we are happy with. Our single great area of difficulty is the need for commission disclosure on risk business—that is, business that is non-accumulative. We represent some 3,500 multi-agents across Australia. These are people who sell product from more than one company. We are talking about small business, the end user of this legislation. The thrust of the bill on the need for commission disclosure on risk business assumes that consumers generally have a problem with agent misrepresentation—the product to them with a view to making a sale at any cost. Frankly, this is far from the truth and we believe it is derogatory to our professional ideals and code of conduct. As evidence of the lack of the problem there are approximately three million individual risk policies in force in Australia. According to the Financial Industry Complaints Service Ltd, which is an independent group, there were 129 recorded cases of agent misrepresentation for the year 1999. They are the most current figures we can obtain. Those 129 cases included both investment products and risk cases. The 129 cases, expressed as a percentage of the three million policies in force, represent a complaint rate of less than 0.004 of a per cent. We would present to the committee here that there is in fact no problem at all. It begs the question: why are we enshrining in legislation a regime of disclosure that quite obviously is not required?

Further, we would say that, if the government and the consumer groups question our motive here, we would ask them where are their facts. We have not seen any facts. We have heard about discussion groups and things like that but we have seen no facts at all. Show us the proof and then we will believe. Further, the bill purports to protect consumer interests. If this is so, why is the focus not on life companies' service standards, which, incidentally, is the chief area of consumer complaint? We also contend that Minister Hockey appears not to understand his own intent when in the bill itself he talks at times about no need for commission disclosure on risk products in the product statement. Then he turns around and says that there is a need for commission disclosure in the statement advice. So there is a lot of contrary opinion there. I will ask my colleague Daryl Foster to present these new facts to you just to clarify that point about the misrepresentation.

Mr Foster—I would like those statistics and that supplementary report presented to the members of the committee, please. These statistics have come from the Financial Industry Complaints Service Ltd, and in reply to the Australian Consumers Association, this is an independent complaints service. In fact, it has three members who are consumers and whose credentials it would be very hard to argue against. They are David Lidbetter, Jenni Mack and Kate Hammond. Contrary to previous comments, they were appointed for the year 2000. This latest report uses 1999 figures, and I have highlighted some sections which prove our statistics. There are actually 45 pages in the report, but I have reduced it to about seven pages. I am happy to give you a full copy of the report as well. On page 3, the independent chairman says about those statistics:

It is pleasing to report that the incidence of agent misrepresentation complaints which reach the Panel has fallen to about 8 per cent. This low level indicates that the Code of Practice which has operated since 1 January 1996 has been effective.

It has been dropping every year. If we go forward a couple of pages, the notes to table 4 state:

Denial of Claim and Service continue to be the most common complaint. Misrepresentation complaints continue to decrease which may be attributed to the Code of Practice.

That is correct. I would also like to refer you to tables 7 and 8. We did not have these statistics available for our report or our previous submission to the committee, but we have now been able to identify things by product. There are two sections to this. In table 7, the first is shown in the column headed 'Personal' and the column headed 'Employer', representing superannuation. The other is shown in the column headed 'Ordinary', representing risk. In table 8, if you look at the cases for misrepresentation in column 3, you will see seven complaints: two of those are in the category called 'Term', two are in the category called 'Income Protection' and three are in the 'Trauma' category. Through this tribunal, out of 800 complaints relating to risk misrepresentation, there were seven complaints for our industry. In fact, if you look at the fourth column of table 8, headed 'Service', you will see that there were 227 complaints about customer service by life offices. That represents 27 per cent of the total complaints. If you look at the independent opinions from life offices on their internal complaints resolution, you will find that the figure is much greater. I present to you those statistics, which support our claim.

I would also like to comment about the idea of a level playing field. When we first read the report, we thought it referred to a level playing field on commission disclosure. However, in the last few weeks we have heard some comments from Mr Hockey and certain other people, which have shown that that is not the case. I will leave with you an extract from something written by Mr Hockey to the AFA which talks about commission disclosure. I will read two comments from that:

These disclosure requirements will not discriminate between different distribution channels or forms of remuneration. They will apply equally to all financial service providers in relation to retail clients to ensure neutrality between different distribution structures.

In another paragraph, he says:

However, advisers will only be required to disclose commission payments where these payments might reasonably be expected to be capable of influencing their advice.

My business partner attended a recent industry meeting which was also attended by Pauline Vamos from ASIC and Senator Ferguson, who was a guest speaker. Both confirmed at that meeting that, if you are a sole independent operator, you do not have to disclose commission at all. I am taking my definition of a 'sole independent operator' from how they read the current legislation: if I am an AMP agent and I have no other agencies except AMP or alliances, I do not have to disclose commission at all, including investment products, because there is no bias in the advice.

CHAIRMAN—Are you saying that you do not have to?

Mr Foster—You do not have to disclose commission. While we agree that there should be no disclosure on non-accumulative risk products, we also agree that there should be disclosure on investment products. The other issue is the level playing field with banks. National Australia Bank, for example, which salaries its people, will not have any disclosure requirements at all. That is not a level playing field: that is a sole operator with an outside agency. It seems unfair that an independent firm which offers the services of 10 insurance companies for advice, is restricted on that advice. I put these facts before you.

Senator CONROY—These finance firms, for simplicity, have multi-agents, is that right?

Mr Foster—As opposed to a tied agency, without any other companies he can use. An AMP agency might have central sourcing where he can have access to other companies. I am talking about someone who only sells AMP or Tower or whatever. That is a bit unfair in the current legislation when you talk about bias of advice. That has been confirmed by ASIC as well.

Senator MURRAY—What happens if you are regarded as an employee under the alienation of services income legislation—would you be required to disclose your commission on that?

Mr Foster—The alienation of income legislation has nothing to do with the FSRB. That is a tax issue.

Senator MURRAY—It has got something to do with it. You have just said that an employee does not have to disclose a commission. If you are deemed an employee by Tax, will you or will you not have to disclose your commission?

Mr Foster—Employee of the bank—because they have sold information.

Senator CONROY—I think Senator Murray is trying to get at the point that these individuals in these circumstances would be having their cake and eating it.

Mr Foster—Yes, exactly.

Senator CONROY—For tax purposes, they will not be deemed to be one thing but, for the purposes of FSRB, they will be deemed to be something.

Mr Foster—Correct.

Senator CONROY—We should have Alan Ferguson back on this committee. He could explain it to us.

Mr Foster—I think we would like the open discussion now, if we could.

Senator CONROY—I want to turn to your submission, but can I thank you first for that invaluable evidence. On the first page of your submission—and I think it is the second of your submissions—you say:

... return from a product commission disclosure serves no useful purposes ...

You make the point that it has the potential to be a 'scurrilous impediment to a legitimate marketing process'. I enjoyed the submission. You say at the bottom of the paragraph:

... it is unwarranted, intrusive, abrasive, picky and ultimately defeated by the Minister's own definitions as mentioned above.

Could you expand on what you mean by that?

Mr Foster—In the product disclosure statement, under part of the FSR Bill, the bill states that the premium on risk has no effect on the return result to the consumer. It actually states that—so it is not necessarily required in the PDS. But in the statement of advice, it is required. It is stated in the FSR Bill to that effect.

Senator CONROY—What do you think would be the impact—and let us put aside Senator Ferguson slithering around behind the scenes trying to put in the fix for his old mates—

Senator MURRAY—That is an outrageous slur on a colleague.

CHAIRMAN—Yes.

Ms JULIE BISHOP—It certainly is.

Senator CONROY—I withdraw. They are sensitive souls today. What do you think the impact would be if you were going to be forced to do this? How will it impact on your day-to-day business?

Mr Maughan—That puts an impediment in a legitimate marketing process. People will have to bring this up right at the start in relation to our commissions. The end result is that the life companies will get very nervous about this and, in their rush to be seen as good corporate citizens, will seek to reduce commission rates, just as they did on the investment products. The end result is that the people like us, the people that market the product, will end up being paid considerably less for our services, yet still have to deliver the same standard. The profit that goes missing there will go to the life office not to the consumer.

Senator CONROY—So your concern is that the big end of town will be able to manipulate it in a way?

Mr Maughan—The big end of town wins again.

Mr Foster—Most definitely.

Senator CONROY—You are accepting that the disclosure in this way could perhaps, in theory, lead to a reduction in cost to a consumer. Do you think that that is a bad thing or is it your concern that the benefits will not actually accrue to the consumer but will actually go somewhere else in the chain?

Mr Maughan—They will go to the life office. The commission is only one of the life office's costs in distributing the product and when that is squeezed down, they keep it. The premium rate will not reduce, so the consumer will still pay the same.

Mr Foster—If I were a life office, I would be delivering a return to shareholders. I am sure those shareholders would not want to see the return depleted as a result of products. They would still want the same return. So one of the issues is staff issues or commission issues—which can be squeezed.

Senator CONROY—But do you see that there is no way for a consumer to have the cost reduced in this process? If you were satisfied that the big end of town were not able to take advantage of this and would genuinely pass on the savings—and we have got Allan Fels to help us there—would you still have the same objection?

Mr Maughan—If there was a benefit to the consumer as the end result, you would probably have to come out in favour and say that it was a good thing for them. But when you look at a term life premium rate it is structured from fixed mortality rates and the expense rate. Knowing life offices the way we do and the devious nature of the beast, I can assure you the consumer will not win.

Mr Foster—What you have also got to remember is the products are not designed by advisers or agents. The products are designed by actuaries of those life offices, with a margin.

Mr Veivers—A major problem for the consumer missing out here is simply that 10 years ago the life offices were doing 100 per cent of the administration. That has now moved from there to about 85 per cent. Our offices are doing about 85 per cent of the administration that is required on those policies. You will find that if our offices are not open to provide the services required you will get those phone centres doing most of the reporting back to the client. They have got a normal lifespan of about two months. They are uneducated on the products. I have done 31 years in the business. There are a lot of old policies there that require service to the client. The client will not get it. Some of those people do not even know the information about some of those old policies. We need to be alive to provide the service to the client. It is not the life office and it will not be any of the ministerial team that goes out there and sells the product or provides the service. In America, 51 per cent of families do not have an insurance policy. You will find here that, if someone is not looking after the mums and dads of this nation, you guys are going to have to carry the can again.

Senator CONROY—You have starkly drawn to the attention of the committee that there appears to be almost two rules here as you described earlier. Is it any more palatable to your

organisation if everybody has to put up the disclosure rather than what seems to be the situation?

Mr Maughan—That would be more palatable. I do not know how they would do that fairly if you are talking about bank officers with salaries. You can hide all sorts of things in there. I do not really know how you would arrive at a fair equation to this.

Mr Veivers—They do that currently anyway. They play the game as it stands at the moment. First you have commission reductions but in the following and subsequent years they catch up. It is just get them over the line and give it to them.

Senator CONROY—Of course. A loss leader in the first year to pick it up later.

Mr Maughan—On the issue of commission disclosure I do not know much about the consumer movement but I certainly know a lot about consumers because I deal with them every day. There is no crisis of confidence out there. I do not have people asking me what my commission rate is. Not only do we serve at the point of sale but we also serve at the time of claim. Generally our consumers are pretty comfy with us. We have been coming to this debate for about 12 years, fighting this particular issue. I have got to say it is philosophical engineering from the consumer movement. There is not a problem out there. We are asking you to accept our word on that. We took people with us from the old ISC regime. We took them up to our office and out in the field. They were just amazed at the confidence that was shown by the consumer in the way we go about our business.

Mr Foster—One of the issues we presented to Mr Hockey at one stage was the rule in the agents and brokers act, which actually said that, if asked, you have to represent the commission to the consumer. We are quite happy to have that in the new act but, to be honest with you, I have been with the industry 32 years and never been asked. In some cases—although I do not run clients, I run a dealer group—when I was running clients, the clients would ask if they should make the cheque payable to me or to the insurance company. Of course, you will make it to the insurance company because people are buying advice from you. They are not so much buying it off the company.

Senator CONROY—That is where I get a little confused in this discussion. You are quite happy, if asked, to reveal this. What would be the difference then to actually disclose it up-front? If you are comfortable with telling consumers the amount, if you are required to tell them rather than just if asked, what is the substantive difference in that position?

Mr Foster—As Paul said, it would drive commissions down. It would not drive the price down. The life office would retain it.

Senator CONROY—A very important differential. I understand.

Mr Foster—So one wins, and one loses. The shareholders receive the extra dollars and, as we said earlier, the price on risk is not an issue . If I quoted a price from Colonial today of $300 for $100,000 cover and I telephoned direct to the company, I would still get the same price of $300. So the only difference is that, if the staff write it, it goes into the big bin. There is no difference in the price movement of the product. If it was reflected in the price offered to the

consumers, yes, but in our experience I would say, no. It has been mooted in the industry—in the PDS—that we should have product disclosure, including the margins for the life office, which could be done and cannot be done in some instances, but I think that is against the big end of town.

Senator CONROY—Your evidence is going to make fascinating reading in the Senate debate. I am happy for you to take my next question as a question on notice to which you can supply a supplementary submission: do you think there is a way that you can make the AMPs and the big end of town actually pass that commission saving on, realistically?

Mr Foster—Good luck.

Senator CONROY—Even with Allan Fels breathing down their necks?

Mr Foster—Good luck.

Mr Veivers—The moment they get heat on them, they turn the blowtorch on us again. That is the problem. We have only to look at the facts there about all the problems they have and what they are doing to right them. I think it is just a big game.

Senator CONROY—The evidence there that service complaints are the source of the problem and not your end of it is compelling.

Mr Veivers—We are at the stage of trying to hold staff, because they get so frustrated in dealing with the organisations.

Mr Foster—I would like to add a comment: if you took term life insurance premiums in 1990 and then took a price today, you would see that the actual rate is 50 per cent cheaper. So commissions have come down dramatically, because of the price, which is fair enough. That is competition. Another factor is increasing mortality rates, because females and males live longer. But the issue that our advisers come across every day of the week is that a lot of life offices out there are still paying the premiums they were paying in the 1980s, because those life offices have never updated those contracts over the years. So, when you come across them, you have good news in savings, provided they are healthy, but life offices never want to pass on that saving to those particular consumers, because that is a bigger profit margin.

Senator CONROY—You would hope their arguments about economies of scale and mergers that have taken place would have allowed some of those savings to have been released to consumers.

Mr Foster—Some have, but there is more profit in those premiums than in the new premiums on the books.

CHAIRMAN—I would like to get your position absolutely clear: you are not opposed to the disclosure of the fact that there is a commission paid, but to the quantum of the commission. However, if asked, you are happy to disclose that commission?

Mr Maughan—The reality is that, if we are asked, you really need to talk about it, Senator. There is no problem with that.

Senator GIBSON—This is consistent with our report from last year.

CHAIRMAN—That is right. And you were probably here earlier to hear the consumer representatives put two arguments in favour of compulsory disclosure of quantum. That was, firstly, that the consumer should have clear information—and they argued that, in the absence of that information, the consumer may be sold a more expensive or less appropriate product, because of varying commission levels. The second argument they put was that they were confident that agents would be able to explain how commissions compare between different products and also how they compare with what is offered by salaried officers.

Mr Veivers—We have had the heat on us since 1989. That is 12 years. A murderer gets 10 years; at least he sees the end of the tunnel, doesn't he? They are still bashing us. This is a bit crazy. These guys seem to have voices to say whatever they like and never produce a figure to support it. As a normal person, I cannot accept that. The figures are very open for anyone to go and collate. It is not a difficult task. They have 75,000 EFTPOS problems. I bet you they will not spend 12 years solving those.

CHAIRMAN—I think your submission makes the point that under the compulsory disclosure you would only be required to disclose the commission on the actual product that you sell.

Mr Foster—That is correct, so that it does not give a variance from product to product.

CHAIRMAN—Not other products, so there is no capacity for you in fact to compare conditions.

Mr Foster—That is right. If you are a sole agent and you do not have to disclose, isn't that a bias, where you are not offering other products? It should be the other way round. If a representative of mine is dealing with 10 insurance companies, and there are research programs that show the rates, the types of cover, and you have got to look in the back room to make sure the cover suits the client, I do not think commission comes into it; it is the actual product. There are a lot of other issues when you are dealing with insurance companies too. It might say that XYZ has the cheapest cover, but then they might have the hardest underwriting to get the case through. You have got to look at the other issues as well.

Mr Maughan—Or the worst claims experience. There is a whole raft of issues that you need to go through.

Mr Foster—You have got to make sure if you sell a disability policy that your client is going to get paid in the end, too.

Senator MURRAY—Good law, in my view, should be consistent across the economy as a whole. An economist might say that your product is no different in economic terms to a tractor or a bottle of wine or a pharmaceutical. It seems to me that commissions are common throughout our society and yet, for the purposes of this law, only one sector is being picked out.

For instance, with a country wholesaler selling tractors, either the company or the individual may be on commission to promote a particular tractor. If you go into a liquor store and you want a bottle of wine, either the person serving you or the owner of the store may be on commission, so the more of that wine they sell—

Mr Veivers—Or incentive.

Senator MURRAY—It is the same. In fact, in America quite frequently sales persons do not get paid salaries, they get paid a dollar rate per product that they sell. That happens in some businesses in Australia: a base rate and whatever else you get is based on the volume. A third example might be a pharmaceutical in a pharmacy. What bothers me, and has worried me right from the start with this legislation, is why a principle of disclosure of a form of earning which is different to wages should be required to be disclosed in one particular industry and one particular sector rather than another. I have not heard it expressed clearly from you, but I think you are distinguishing between products where the choice of the consumer makes a difference to the eventual return compared with risk based products where there is no return on results, it is simply a dollar consequence.

Mr Foster—Correct.

Mr Veivers—That is correct.

Senator MURRAY—So, if I understand you correctly, you are putting your product in the same batch as the bottle of wine or the tractor and not in the same batch as other discretionary products where influencing the consumer really does affect their lifetime financial consequences. If you drink too much wine it will affect your lifetime experiences, but that particular choice does not.

Mr Veivers—That is correct.

Senator MURRAY—Is that the point of integrity you are trying to arrive at in your campaign?

Mr Veivers—Yes. I think you said that very succinctly and you might like to join our committee.

Senator MURRAY—Is there a commission?

Mr Veivers—It depends if we have to disclose it or not.

Senator MURRAY—I am quite happy to disclose it as long as the quantum is high!

Mr Veivers—We are slightly different to the wine seller inasmuch as when the wine buyer takes it home and consumes it he does not have a 14-day money back guarantee, and if he takes it home and sits it under his house and decides he does not want it he cannot take it back. The insurance company takes our money back within 12 months, so if we do not sell the product

correctly and the client opts to change because of that, the insurance companies take our income back off us, but they keep all theirs, and the client misses out again.

Mr Foster—And there is no independent complaints tribunal.

Mr Veivers—So it is a little bit different again—there is a double whammy there to protect the client.

Senator MURRAY—My further point is that you are being required to disclose your margin—in fact, your commission is your entire margin.

Mr Foster—It is gross.

Senator MURRAY—Whereas others who take profits in this transaction do not disclose their margin.

Mr Foster—That is correct.

Senator MURRAY—I do not understand that principle.

Mr Foster—Nor do we.

Senator MURRAY—Why should one party that is taking the margin be required to disclose it and not the other? Once again we should look at principles across our general economy. Nobody requires the owner of a liquor store, a food store, a pharmacist or a tractor to show what margin they are making on each product. I think it is an odd principle which mixes that up. Frankly, if the legislation were to force you to disclose it, I would like them to disclose what the life outfit is making as well and perhaps put some of the consumer heat on them.

Mr Foster—It makes it a lot fairer from a price driven point of view.

Senator MURRAY—It is quite plain that this has been an area of great aggravation within the policy development process. It is no secret that within the caucus of the Liberal Party this matter has been debated quite strongly—at least it is no secret to me. Might I suggest that you give some further thought to a supplementary submission and try to explore some of the concepts I have outlined to you to more clearly express the differences that you are trying to outline. Whilst your submission does have a couple of exciting terms, I am not sure that you have got your point across well enough. That is my view.

Senator CONROY—Scurrilous makes the point.

Senator MURRAY—That is quite strong. I am not being overcritical, but it is quite plain that you have not persuaded the government to your view. It might be because you have not expressed it clearly enough. Can I move back to the employee issue. My understanding of this legislation is that employees do not have to disclose commissions.

Mr Foster—It does not actually state that. It talks about influence or biased advice.

Senator MURRAY—Perhaps somebody can explain to me whether they do or do not. If they do not, it seems to me that, if the alienation of services income legislation results after the event in a person who thought they were self-employed being actually declared for the purposes of tax as an employee, then the legislation here should be explicit. If that happens, then for the purposes of this legislation they should be an employee.

Senator CONROY—Are you trying to kill two bills at once?

Senator MURRAY—I think it is unfair to treat people one way in one system and another way in another system. It is an issue of fundamental fairness. Perhaps you would have a look at that in your supplementary remarks for me as well and be clearer on this matter.

Mr Foster—Thank you. I agree.

Senator CONROY—Did you raise these questions with this travelling 'ASIC-Senator Ferguson road show'? Have you had a chance to meet with this road show?

Mr Foster—No, not at this point in time.

Senator CONROY—Are you trying to catch up with him?

Mr Foster—We have in the past supplied Senator Ferguson with statistics and we will be sending him copies of what we have here as well.

Senator CONROY—Do any of you know what Senator Ferguson used to do, apart from farm, before he went into parliament?

Mr Foster—Yes.

Senator CONROY—What was that?

Mr Veivers—He was a Colonial Life agent.

Senator CONROY—Would that mean that he was tied to only one company?

Mr Veivers—In those days it would have, yes.

Senator CONROY—That is an interesting coincidence.

Ms JULIE BISHOP—These are people with background experience in business, Senator Conroy.

Senator CONROY—That is a good thing too.

Ms JULIE BISHOP—I am glad you agree with that.

Senator CONROY—You have to understand it before you put the fix in.

Ms JULIE BISHOP—Are you going to withdraw that one too?

CHAIRMAN—Can we have less banter along the table! We are well behind schedule and I do not think it helps.

Mr Foster—Can I also make a comment on what was said by the previous speakers from the Australian Consumers Association regarding bad things in the industry. A lot of these bad things seem to relate to the eighties and we are legislating from the year 2000. In the nineties we brought out the code of practice in our industry and, whilst it is not legislated, that code has improved the industry dramatically. I make the comment that groups going into towns or selling door-to-door does not happen that much anymore in the insurance industry. Firstly, you need a fact finder and a needs advice. Secondly, it did happen in the eighties, the industry fixed it, but we seem to be legislating on comments from the Consumers Association about what happened in the eighties. Those problems are not there any more and that is supported by those statistics.

Ms JULIE BISHOP—Just picking up that point, if we are talking about the best interests of the industry generally, given the very much 2001 collapse of HIH—and I appreciate we are talking about different areas—obviously there is going to be a level of fallout over the next few months as the royal commission and other bodies investigate what went wrong in HIH, and issues of price and who knows what will come to the fore. This is not a great environment for a segment of the industry to be arguing against disclosure, is it?

Mr Foster—Yes, but I think those are two separate issues. Is this a public committee?

Ms JULIE BISHOP—Yes, it is.

CHAIRMAN—But you are protected by parliamentary privilege.

Ms JULIE BISHOP—Before you answer, I appreciate the difference. I am saying that we are talking about the insurance industry generally coming under the microscope and that you are arguing against what might be perceived to be greater transparency at a time when industry practice may well come under very critical analysis.

Mr Veivers—I think that is probably not so. It is a very shallow view. I think what we need most of all in the marketplace are people like us on the ground holding hands with our clients, which is more important today than ever before, and taking them down the path as best we can. We cannot control the life offices, nor the principals of the life offices, nor the products that are produced by them. We can analyse them and study them and be coerced by them to sell their product—if we feel good about it, we would and we would encourage people. But, really and truly, these people need, on a day-to-day basis, to have our offices open for them to ring. They are not going to get any support from companies like they did in the past. They have got nobody on the ground; they have got call centres. As I said before, people at call centres last probably two months, and they are uneducated compared to us who have done 30 years in the business. I am totally of the view that our clients out there need much more support than ever before.

I would not be totally concerned about what HIH did, in terms of what you are saying. I would be going the other way and saying, ‘These guys need far more support and they need people in the field.’ We have seen what happened when changes happened in the investment

market—16,000 agents went down to six in this country. If it gets too tough, it is pretty simple: like anybody, if life gets too tough, you walk away and create another business somewhere else. We are successful in our own right, so we would do that. In the end, there would be no-one there to look after them.

Mr Foster—If I could just add that, with HIH, there are probably two issues—

Ms JULIE BISHOP—I was trying not to concentrate on that. I was saying, 'This scenario, that background.'

Mr Foster—HIH's debacle or downturn was not caused by agents or brokers. It was caused by mismanagement or claims. The insurance company—

Ms JULIE BISHOP—I do not know what is going to come out in the wash.

Mr Foster—The insurance company sets the prices and the margins; someone else sells them. If the premiums were not there to cover the claims or there was mismanagement, that is a liability that HIH has to deal with.

Ms JULIE BISHOP—One of the difficulties I have is the point that Senator Conroy picked up, that you are prepared to disclosure commissions if asked, but not otherwise. It is a fine distinction, isn't it?

Mr Veivers—Yes, I guess it is. Of all the commissions that need to be disclosed, ours would be the most difficult. I had a meeting with the admin staff of a life office once just to try and appease them on their views of the agents with the company. We sat down and said, 'With all the income streams that you see going to those agents, who do you reckon gets the money?' They said, 'The agent does.' I said, 'It's not true. They have got to run a business; they have got leases on properties, they have got staff and superannuation for staff and everything like that. At the end of the day, they simply get a salary.' It impedes our ability to run a business. We are all small businesses in this country. If we do that and put more pressure on it, again, we are not going to have people out there getting the right advice and the best support.

Ms JULIE BISHOP—So what if consumers become ultra savvy and start asking every single time for disclosure of your commission?

Mr Maughan—I guess we tell them. The issue here is that currently people do not ask so therefore there is no need to talk about it. If we talk about it what will happen, as we said before, is commissions will come down and life offices will win.

Ms JULIE BISHOP—Why does it follow that if you talk about your commissions they will necessarily come down?

Mr Maughan—Because life offices want to be seen as good corporate citizens and if there is any sort of heat on in any area at all, rather than try to explain it, they will reduce the problem to take it away.

Ms JULIE BISHOP—Where the product is at the same price to the consumer?

Mr Maughan—That is true. It has no bearing on it but they will just run from it.

Ms JULIE BISHOP—So you think a consumer says, 'All right, it's going to cost me $100 whichever product it is', but because you get $16 out of one and $10 out of the other he is going to say, 'I don't want the one where you, my dear friend of so many years, actually makes a buck'?

Mr Foster—In actual fact, the one that is costing less might not have the same amount of cover either.

Ms JULIE BISHOP—You rely on statistics. I have some concern about that because you are saying that the number of complaints about misrepresentation or whatever is so low. The question is how high does the statistic have to be before you would be concerned. I do not know that the reliance on statistics is as valid as you might think as a persuasive argument. Often it is a question of what is best practice across the industry rather than waiting until there is a five per cent, 10 per cent or 0.07 per cent rate of complaints about misrepresentation. It is more a question of overall best practice. Can you comment?

Mr Maughan—That is fair comment. But we are saying there that the agent misrepresentation is a very low figure compared to all the other complaints. The major complaint from consumers is with the life offices yet they are disclosing nothing.

Ms JULIE BISHOP—But the statistics alone are not an argument for not addressing the issue if otherwise it were perceived to be best practice.

Mr Maughan—Fair comment, but I would have thought that we are pretty clean. I do not know how clean we have to be. There are not many complaints. I think doctors kill a few more people on the operating table than we do.

Ms JULIE BISHOP—Some of my best friends are doctors. On this issue of drawing a distinction between the scenario where an agent is promoting or recommending particular products and a bank officer, given the obvious branding involved, you do not see any difference in that scenario? You are talking about a level playing field so there should be no difference between a bank officer, given the branding—

Mr Foster—That is correct because the product pricing is done by an actuary. If I went into a computer and did a quote on a risk product or an investment contract it would show the Commonwealth Bank as well and their margins. It does not say charges under risk by the bank life office but the bank itself is a seller of the product. If you took the National Bank, for example, you have got National Mutual Funds Management behind the scene which is the life office which the bank takes no liability for so there is an arm's length transaction, but in essence there should be full disclosure on their basis as well. It is not a level playing field. The bank's salary could be the same as commission but called salary. It could be a bonus.

Mr Veivers—Then there would be a gap between all the other staff and the bank manager who would take a bonus out of profit because his branch did well and that would be as a direct

correlation of the commissions sales as well so it becomes too difficult to determine what part of their situation is commission—

Ms JULIE BISHOP—And be attributable to the sale?

Mr Veivers—Yes. It is so hard.

CHAIRMAN—Thank you for your evidence.

[11.16 a.m.]

MORGAN, Mr Murray Kenneth, Chief Executive Officer, Insurance Advisers Association of Australia

CHAIRMAN—Welcome.

Mr Morgan—In our original submission we did note that we had applied to ASIC to change our name in line with the FSRB bill to take advantage of the word 'adviser', and that has gone through.

CHAIRMAN—We will note that.

Mr Morgan—We still retain the IAAA.

CHAIRMAN—We have before us your submission No. 27. Are there any corrections or amendments to make to the submission?

Mr Morgan—One minor one—and it was raised by the previous speakers—regarding commission disclosure. I have said in the past that we should leave the disclosure commission as it currently is under the agents and brokers act. Like most people in Australia, I have been under the false impression that agents were required to disclose when asked; they have not been. If you read the act—and I had it pointed out to me—it was only ever on brokers. The agents did not have to disclose, but I think most did if they were asked. I can honestly say that, in all the years I was out there since 1984, I have never been asked for my commission. It was in our submission that we leave it as it is and, as I said, that only applies to brokers. We would be recommending something along the same lines but applying to all advisers.

CHAIRMAN—We accept that change. Do you wish to make an opening statement? If so, you may proceed and then we will have questions at the conclusion.

Mr Morgan—I would like to thank the committee for the chance to appear today. I would also like to thank the minister, Mr Hockey; the Treasury; ASIC; Senator Ferguson; and the members of this committee who over the last couple of years have put up with me coming to annoy them and their advisers in their offices as we put the case for what we believe is in the best interests of the industry and our members. The IAAA is not against change. There are many things in this bill that we do support—the educational side, IPS 146 in particular. We have taken that as a real challenge and are working with the Insurance Institute of Australia, under its new name, to devise new programs for our members. That has already proved successful. Seeing that they are going to have to undertake some further education, people have started already. The important thing, we feel—and it is something that we are very pleased about—is that the assessment part, rather than formal education, has been basically supported.

As far as commission disclosure goes, the example that most of our members use is in a small country town. Bear in mind that our members are scattered all over Australia and, as a percentage, there are not that many of them in capital cities. In a small country town the problem they see is that, if they are forced to disclose up-front what their commission is and the

potential client sees that there is an $800 commission being made by the seller, he is going to say something along the lines of, 'You do know me; we have been friends for years; what say you keep $400 and I keep $400?' That might sound like competition, but any business relies on a good deal to carry some of the not-so-profitable deals. Our members in the country, particularly, and some in the city, write a lot of business in which they do not make money. With third party only motor vehicle, they may make $7.50 on a deal. They may make $40 helping a pensioner with a household policy which is worth $200. In order for a business to be sustained, it has to be viable so it does need a good deal.

That is one of the worries: that the good deals will be taken away when people see the potentially large figure involved. That is one thing. Another thing: if I go to buy a Tattslotto ticket, I know that each game is going to cost me 30c and, depending on the week, I may win $1 million or $2 million, or, on 30 June, $20 million, at which point I would be retiring. The thing is, do I need to know how much the government is taking in tax out of my 30c before it comes to a dividend? Do I need to know how much Tattersalls are taking for the beneficiaries of the Tattersalls fund? To me, that is an unnecessary piece of information. The only thing I need to know is whether I can afford to pay the investment against the possible return. I know that insurance is not meant to be quite that much of a gamble but the principle is very much the same. The person is saying, 'I need to cover myself against a potential loss and you are telling me that this is the premium I have to put up-front.' If the premium that is put up-front seems reasonable to me, I will take it. So I really do not see the need for disclosure. That is all I have to say, but I am happy to answer questions. Hopefully I will be brief and let you catch up on time.

Ms JULIE BISHOP—On that point, isn't there something to be said for the concern that an agent might be tempted to push a product where there is greater commission for them that is not as appropriate—and it could be in just questions of degree—as another product? In those circumstances, given that you have acknowledged that they can ask the question anyway and you would be obliged to answer, shouldn't that be part of the information that a consumer should have before them when they make this decision to take out a policy?

Mr Morgan—With respect, I think I just answered that. I do not think it is. The only thing that the consumer really needs to know is what the end result is that they are hoping to get and what it is costing them, and I think they weigh up the two figures—

Ms JULIE BISHOP—Cost is one and appropriateness might be another.

Mr Morgan—Most of our members are on the general side. There is not a great deal of difference between car policies and house policies. You can have bells and whistles, but I do not honestly believe that people who are in a business where they have to renew the contract every year to keep a client are going to do anything to prejudice a long-term relationship. Where a contract is renewable every year, they must keep that client happy or they do not have a client.

Ms JULIE BISHOP—Does your scenario of a country town where you go along and see your mate, sell him a product and he says, 'What's the commission? Let's split the difference,' happen now?

Mr Morgan—I suppose it does but it has not happened to me. That was one of the things that was raised by some of our members. They felt that would happen or could happen when people knew up front something they did not think they needed to know in the past.

Ms JULIE BISHOP—It could happen anyway where a savvy consumer asks the question about a commission anyway.

Mr Morgan—It could, but you are certainly opening the possibilities much wider if in your opening gambit you are saying, 'I'm going to get 20 per cent of whatever you pay.' Is that really a piece of information that is relevant to the decision of the person who is taking out a house policy, car policy or whatever it is?

Ms JULIE BISHOP—Except that it would all be on the record at that point. Your up-front statement of the commission being then on the record is less likely to lead to somebody doing a little deal on the side.

Mr Morgan—I think you can take that point to the nth degree. There are probably another 100 items of information that the insured might like to know such as, 'How long have you been in the business?' down to, 'How many claims have you had made against your PI policy?'

Ms JULIE BISHOP—You would tell them if they asked, wouldn't you?

Mr Morgan—Yes. But I am just saying that you can get to information overload. As a consumer, I sometimes get handed piles of paper for information before signing a contract and I think, 'My God, do I really need to know all this?' I think we can be overprotected as well as underprotected.

Senator CONROY—In your submission, you say:

> We believe after reading the Bill and the 'Explanatory Memorandum' that disclosure of commission on 'Risk Products' is no longer a requirement. This is based on 1013D of the Bill and 14.95 of the Explanatory Memorandum.

The minister is maintaining publicly that he believes it still is the case. Could you just take me through your reasoning on those sections? Have we got a copy?

Mr Morgan—I have a copy in my briefcase.

Senator CONROY—As we privately discussed, there seems to be some confusion about what the actual impact is.

Mr Morgan—I have asked ASIC the same question.

Senator CONROY—There are three documents.

Mr Morgan—In the memorandum, paragraph 14.95, on page 148, states:

> Where the commission paid does not affect the return from a product, no disclosure is required. The amount of commission will, however, be reflected in the fees, charges paid by the consumer and disclosed under proposed paragraph 1013D(1)(d). So, for example, commission will not need to be disclosed as a stand-alone item (that is, distinct

from the amounts paid by the client to buy the product) for most risk insurance and other non-investment products where the commission does not impact on the return from the product. For the most part, when a consumer purchases a risk insurance product they pay a premium in order to insure against a future risk. If and when that future risk eventuates the consumer will receive the amount for which they were insured. Even though the premium the consumer pays included a portion that will ultimately be paid to the financial service provider as commission, the payment of the commission will not affect the amount paid if the event occurs.

We would love to see that particular clause in the bill rather than in the memorandum. We believe it is clear. I know there are legal firms that have produced opinions, and accounting firms, and I think the score is about fifty-fifty each way on interpretation.

CHAIRMAN—If I might intervene there, Mr Morgan, I think that refers to the product disclosure statement. The SOA does require disclosure. That is where a bit of confusion has arisen.

Mr Morgan—Yes, there is confusion.

CHAIRMAN—There is definitely disclosure required on the SOA, but not on—

Mr Morgan—We are saying this is what we believe it should be now.

CHAIRMAN—You are saying that should apply to the SOA as well as the PDS?

Mr Morgan—It should apply everywhere.

Senator CONROY—What does the legislation require, as opposed to the explanatory memorandum? It requires the production of these pieces of advice?

Mr Morgan—Yes.

Senator CONROY—And you are saying that the explanatory memorandum means that in neither of them will this disclosure be required?

Mr Morgan—We believe it should not be required anywhere—that is what we have said.

Senator CONROY—But you are saying your interpretation is that it is no longer required?

Mr Morgan—Yes.

Senator CONROY—Whereas there still seems to be an argument that it is required. I am still trying to get to the bottom of this.

CHAIRMAN—It is required on the SOA but not on the PDS. What Mr Morgan was quoting related to the PDS not the SOA, both in the memorandum and the legislation.

Senator CONROY—So do you envisage that when the sale of a risk product takes place there is not the requirement on the SOA?

Mr Morgan—It should not be in the SOA either.

Senator CONROY—No, I am saying: when you are selling a risk product, is the SOA required to be given to the consumer?

Mr Morgan—Yes.

Senator CONROY—Therefore, disclosure will take place to the consumer in that document?

Mr Morgan—It would, as I understand it, yes. But we do not want it.

Senator CONROY—I understand you do not want it. So you are accepting that it is required in the SOA?

Mr Morgan—Yes, which we did not originally—we read that and thought we were safe at that stage.

CHAIRMAN—So you mistook what referred to the PDS as also applying to the SOA—

Mr Morgan—Yes.

CHAIRMAN—and it doesn't.

Senator CONROY—So you accept that the disclosure will take place in the SOA?

Mr Morgan—If it is unaltered, yes.

Senator CONROY—So you wrote this report before you had got that—

Mr Morgan—Clarified.

Senator CONROY—Okay. I think I am clearer now, thank you. I think you heard the evidence of our last witness about a meeting that involved an ASIC officer and Senator Ferguson with AMP?

Mr Morgan—I heard part of it.

Senator CONROY—Were you familiar with the interpretation in terms of just working for one company as—to use my old language from my old days—a tied contractor, or a single agent versus a multi-agent?

Mr Morgan—I had heard that from Senator Ferguson a couple of weeks ago. I had not been aware of it before that.

Senator CONROY—Have you seen that in writing anywhere in terms of information that is available to the committee?

Mr Morgan—No, I have not.

Senator CONROY—Perhaps we could call Senator Ferguson.

Ms JULIE BISHOP—What would you call him?

Senator CONROY—I have had to withdraw a number of things so far. I would be happy just to call him to the table.

Ms JULIE BISHOP—The people's hero!

Senator CONROY—Certainly the ASIC officer that is named might want to be available for the committee tomorrow. That is not a question to you, Mr Morgan. It is a question to anyone in the room who is listening and shaking their head. So you are not aware of anything in writing, only those verbal statements. I think your organisation has been arguing in relation to the contractor legislation, in terms of the tax advice, that it is an unfair interpretation for it to incorporate people who are tied to one agent or one company. Is that a fair representation of your position?

Mr Morgan—Yes. Someone else is handling that, not me.

Senator CONROY—I was not going to ask you any detailed question on it. But the position of your organisation is that people who are simply tied to the fact that the product comes from them but have many clients should not be incorporated in that legislation because it does not represent the true economic position; that they attract the individual clients and therefore the tax legislation should not be seeking to rope them in as only having the one client—for example, the company AMP. That is consistent. Do you think it is fair for there to be, on the one hand, a definition by the tax office that says you are an independent for the purposes of tax but, on the other hand, a definition by ASIC that says that for the purposes of the FSRB definitions you would be considered to be independent?

Mr Morgan—I do not think anywhere where you have two different definitions of the one—

Senator CONROY—This by two government agencies. This is going to cause chaos.

Mr Morgan—I do not think it is ever fair. It may be advantageous if you are lucky enough to be on the right side—

Senator CONROY—Fair comment.

Mr Morgan—I would honestly have to say it is never fair to have two definitions of the one thing.

Senator CONROY—Tax normally wins those sorts of arguments at the end of the day, do you think?

Mr Morgan—I never argue with the tax office. I tell my accountant, 'Just keep paying until it hurts too much.'

Senator CONROY—Fair comment. It would be unusual for ASIC to be able to define something separately from the way the tax office define it, but we will investigate that with someone else.

Senator MURRAY—Mr Morgan, it seems to me that the purpose of disclosure in the bill overall has this view: persons who make a large commission or a large quantum will steer their clients towards that product which gives them the greatest return but is not necessarily best suited to the consumers' needs. And the consequence of transparency and disclosure in economic terms will inevitably mean that price will come down, commissions are likely to be squeezed. That is my view of it, based on a knowledge of both the forces of competition and the forces of economics. What do you think of the general view I have that this disclosure is then only partial and is directed at the middlemen and not the ultimate beneficiary? Let me give you an example before you reply. Generally speaking, if you take a mortgage from a mortgage provider, you are fully acquainted with the cost: here is the percentage, here are the fees which are over and above that, and if you cancel—

Senator CONROY—There is a commission. They do not disclose that they are actually getting a kickback commission from the bank that provides it, so they are not fully—

Senator MURRAY—I am talking about a gross margin. You know what the gross margin is—it is comprised of the interest rate, the fees attached to it and, pretty well, you know what the fees are for paying it off early. There are other issues which Senator Conroy outlines. It seems to me that here only part of the margin is going to be disclosed—namely, that part of the margin which accrues to the broker or to the agent. If we are going to go down this route, and be consistent, do you think that perhaps we should be rather arguing for total margin disclosure, so that the life company or the financial product owner—the AMPs of the world—have to disclose what their gross margin is? I put this question to you because I fear that the price pressure is going to be on the middleperson, the middleman, almost the wage earner, if you like, whilst the big end of town—as it was described by an earlier witness—will have no restraints on it at all.

Mr Morgan—I think any pressure on the commission rates will certainly not automatically go to the benefit of the consumer. At the moment, on the general side of the industry, pressure is on commissions. Agents and brokers are doing far more work than they ever did, with electronic transfer, et cetera, and those people who are not up to speed with electronic transfer are being hit with reduced commissions if they do not.

So, in other words, where you were getting 20 per cent if you were not doing it on electronic transfer doing the whole bit, really cutting down their handling, you get reduced over a period of time. The overall picture is that, if you are not on electronic transfer making it easier for the underwriters, the most common prediction of people who are not fulfilling that charge is that you will find yourself without an underwriter within two years.

It is interesting that you say that the underwriter shows the end result, but we all know what the end results of underwriters are—they are produced each year and most of them are losses anyway, unless they have had a good investment year. Jumping on the other side to ours, it is pretty hard on the underwriter in that we have just had the collapse of a major underwriter because they wrote business too cheaply. Now we have everyone—consumer groups and other people—saying that the industry, which is being forced to pick up business that in a lot of cases

they do not want because they do not think it is good business, are being told to pick it up at the rates HIH had it at, or to take it at the rates HIH had it or with very limited increases. I find that totally bizarre because people want insurance companies to be around at the end, but they want them to write it at premiums that have just proven to be uneconomical.

Senator MURRAY—But you yourself made the point—not directly, but I think that was the inference—that if an agent providing a number of products is squeezed on the other side to maintain their income they will just have to raise the price on that one. They are presently providing those products very cheaply—I think you gave a figure of $7.50 for one product. So there is the possibility that prices will move up in some areas. I really want to put it to you this way: if you deal with it as a safety issue, what you want to ensure as any government is that products available to the community are safe and are not deceptive—in other words, that they will do the job you say they will do. That, in a broad summary, is the purpose of much legislation.

From a competition point of view, you want to make sure that competition is maximised and people are not taking excess profits through manipulation of an industry, therefore transparency is desirable. If you are going to expose situations where excess profits may be taken, in a disclosure regime you cannot only disclose part of the chain. That is essentially what I am saying to you. You have to disclose the whole lot. That is the weakness at the heart of this legislation. Only one part of the profit-taking mechanism is being asked to disclose.

Mr Morgan—We agree with that. A level playing field would be great. I do not agree with the whole concept of risk disclosure, but I cannot see how you could ever get the companies further up the chain to disclose anything other than their end results. The only other thing is that if you have to have something in there to warn the consumer about the commission, put it in there that you have the right at that stage to ask if you are interested. I still think a very small percentage would ask, unless they got magazines coming at them saying, 'When you go and see your insurance man, be sure to ask what that is.'

Senator MURRAY—You are obviously not acquainted with all this stuff that we receive as parliamentarians, and I am not debating with you in that sense. But, for instance, this committee is involved right now with reviewing the views of the Reserve Bank and APRA and other bodies such as the ACCC on fee transactions for credit cards. The committee is of the view that disclosure by the bank is required, because they have been taking excess profits. I simply make the point that you cannot have partial disclosure if the purpose is designed to increase competition and to increase transparency. I will leave it at that.

Senator CONROY—I return to an issue that Ms Bishop raised. She talked about how customers could perhaps be steered into a product if there was a greater level of commission for the agent, rather than if there was benefit for the customer. I appreciate that there is no evidence that any of your members have been doing this, but recently two banks have been made to give enforceable undertakings because of unconscionable-conduct type of practices. Are you familiar with those instances of pressure being brought to bear on individuals that are doing the wrong thing?

Mr Morgan—As I said earlier, there is not a great deal of difference in commission between one underwriter and another on the general insurance side. When I was a broker, 20 years ago,

there were differences. In those days, you could have variations of between 15 per cent and 30 per cent on commercial products. Today, it is down to the basic 20 per cent if you are on electronic and doing all the transfers, and I do not know of anyone paying more than that. I do not think there is the scope to be tempted—there is nothing being dangled there—and I hope that people would not do it.

Senator CONROY—Unfortunately, we have two recent examples of two major corporations with practices that have pushed their staff into this situation. The consumers' argument is that one way to try to spike this informal, subtle pressure from banks to their staff is to require disclosure. We would like to think it never happens, but we have had two recent examples. Do you have a view of whether or not disclosure, in that instance, could assist and protect a consumer from being channelled into a product that is maybe not quite as good for them but a bit better for the staff member who is pushing them in that direction?

Mr Morgan—I will try not to be parochial—but, in all honesty, you have to adopt the principle that you either have disclosure or you do not, and if you do not then it should apply to everybody.

CHAIRMAN—Thank you very much for your appearance before the committee.

Senator CONROY—Thank you also for your succinct answers, as promised.

[11.43 a.m.]

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

NOWAK, Mr Joseph, National President, Association of Financial Advisers

MURPHY, Mr Michael Francis, Principal, Murphy Financial Services (SA) Pty Ltd

CHAIRMAN—Welcome. We have before us your submissions, 6, 6A and 50—which are numbered according to our numbering. Do you wish to make any amendments to those submissions? If not, do you wish to make an opening statement? If so, you may proceed and then we will move to questions.

Mr Nowak—The Association of Financial Advisers commenced in 1947, and we are now 54 years old. Our members employ staff of around 30,000, which makes it a small business. It is interesting to note in passing that staff were left off the current ASIC list for operating a financial services industry. There is no code of practice for the staff, and we are concerned about that. We support the FSR Bill. We believe that financial services should be properly regulated and that consumers should be protected. We look after our clients. As consumers become our clients, our clients become our best marketing people. We believe in the old adage: if you do the wrong thing then 10 people will talk about you, but if you do the right thing, one on one, they will not talk about you. If clients do not promote us, we will just wither.

We have been concerned that much of the good work in superannuation retirement planning in protecting income and providing life insurance protection through death cover, may be lost altogether with the current personal services in the market by placing current agents, especially the multi-agents, in the situation we are going through with all these changes. Banks employ advisers who do not provide personal services. They do not build up personal relationships as they provide quotes. These advisers are busy building up clients at the moment through cold calling and the clients are then owned by the banks. There is no service in that whole arrangement, and the whole thing is heading that way.

Last week I got a call from American Express, from a 20-year-old boy called Michael. He said, 'Joe Nowak?' and I said yes. He said, 'I've got an accident plan for $400 a day,' and I said, 'Yes, very interesting. Tell me more about it.' He did not know who I was. I said, 'Does it provide sickness cover?' and he said no and I said, 'Fine. How long does the cover go for?' He said, 'I had better let you know about that too.' Secondly, I asked him, 'What is the waiting period? Is it 14 days, 30 days, 90 days or two years?' and he said, 'I'll get back to you on that.' Then I said to him, 'Do you have a guide?'—under the new bill I will call it a P for the product and I will call it an S for the statement—I went back to the guide, and I said, 'What's your guide? Can you fax me on who you are, what you sell, whether you sell for commission or salary or what you do?' He said, 'I don't have one.' Then I said, 'What about the product statement? Did you send that?' and he said, 'I sent that to you two months ago.' So that personal call is true.

The next call was to my accountant. I had lunch with him. Vic Burdett is my accountant, and he has been my accountant for 31 years since I started my business. He got a call from his National Australia Bank branch manager. I am under privilege here, correct?

Senator CONROY—Yes.

Mr Nowak—The branch manager said, 'I have just had a look at the deductions coming from your statements—up to $15,000 in your super and disability and everything else. I can beat that deal for sure. I can look after you.' The branch manager was trying to make an appointment with Vic. Vic rang him back, and I will not tell you what he said.

Ms JULIE BISHOP—The NAB guy rang up your accountant as a result of reading your accounts?

Mr Nowak—That is right. Vic and I started in grade 1 and finished in the first XI and the first XV, so you can understand the bond that we have. I played lock, he played half-back, so that is pretty close. Anyway, we went through that. I was having dinner with two other gentlemen, one an old schoolmate, and he said, 'Who is going to look after Lani if I die, if something happens to me? Joe, I've known Lani since we were 17 years old.' That was his 10th bank manager. That is what is happening in the marketplace, so just be aware of that. This happened to him.

The other situation, as I said, is that there is a lot of cross-selling, and people are accessing accounts, they are still doing that, and it is a disgrace. In our submission there are eight concerns—and you have them in front of you. Do you want to turn to those at this stage, because in our submission we do relate that to the alienation of income and how we progress with us as multi-agents going forward into the new regime. We have got some concerns. We have written to Joe Hockey and I have met with him, and we still have not got it right. There is still going to be a lot of business disruptions for us to get through that gap. Commission is one of them, but I will explain to you how that works as well.

The first point there is headed 'Changes in the Agent/Principal Arrangements'. What is happening at the moment is that we work under the Agents and Brokers Act whereby I work for four companies and, because I have less than 80 per cent of my income coming from one source, I get through the alienation situation. I do not have that one source situation. Our association has worked very well with the ATO, through Mick Lyons and Tony Sullivan, to get through the situation. We have put up situations which will get through a lot of this—Senator Murray, I will explain that to you later if you ask that question on how we go forward. I am also asking to meet with Senator Kemp's office to go through that.

At the moment, going into the new regime, because I am a multi-agent, so I work through four companies, I have the protection of common law and I do not have this tax problem. Going into the FSR, I have one dealer who channels all the money into that dealership and then I get my money here. So the dealer gets money from four companies to him and, firstly, that sparks the problem with the alienation. Secondly, at this end if he falls down, my concern is that, say for argument's sake that dealer does something and does not cross his t's and dot his i's with ASIC, he goes down like Chapel Road did recently—and 37 agents did not get paid for three months. The money gets locked in here. I cannot pay my bills. I said to Minister Hockey, I may as well go up to Sydney Harbour Bridge and jump off and get it over and done with because I will go broke. So that is a real concern. And yet we were told we had no business disruption. That is the first part.

With regard to change to commercial value, at the moment I have an asset renewal register. We get paid a percentage for moneys coming into our business which helps to run my office and service. I have got two staff. After 31 years I have got a few hundred clients. Most of the clients these days, because of the fact that there is no service in the companies, ring you. I encourage them to do that, and they get a calendar. So the first port of call is me, then my staff handle any situations. That is the best way to do it. It cuts out a lot of nonsense and you do not have to go through that aggro with ringing the companies; you are in control and you are doing a service.

At the moment, we pay a little bit through our dealerships, so if I have a $200,000 cash flow it might only cost me $10,000. But going through here is going to maybe cost me 10 per cent—it is going to cost me more money. No-one has thought of that. In terms of the commercial value of my company, whereas I could get three times the cash flow or the asset renewal commission, we reckon it might drop 50 or 60 per cent. It is a real concern for our business that we have built up for years.

With regard to alienation of income, I mentioned the issue of one source. But we have got a reply from the minister saying that we can have two dealers if we want to do different products. The industry is not encouraging that. ASIC are disputing that with me—I have seen ASIC on that. So, on alienation, two things could happen—

Senator CONROY—Part IVA might apply to the minister at this point.

Mr Nowak—The minister has said that we can have dealerships which are product orientated and there would be no worry about reliability. But I do not think the industry will allow that. That is our main concern. It will do two things. It will give us a bigger variety of products. At the moment dealers are only allowed to deal in 10 products. If I go to another dealer with 10 other products I can deal with those other 10 products, so I would have 20 products and I would also have the alienation problem in check. That is the concern we are going through at the moment.

Senator CONROY—Do you think that, in an ideal world, the major companies would like to eradicate the multi-dealer, the one with more than one licence? You say it is very fixed. I have heard some suggestions that it would make life a hell of a lot simpler for the big end of town if they could just eradicate people like you.

Mr Nowak—Correct.

Senator CONROY—I am sorry to have interrupted.

Mr Murphy—CHAIRMAN, I have a couple of notes to add to my original submission. I did not know how we were going to work this, but maybe if I went ahead and read those now there may be a more common understanding.

CHAIRMAN—That in fine. Go ahead.

Mr Murphy—Thank you for the opportunity to make a presentation this morning. It is an individual submission, which I believe you have received, and I would like to summarise its contents, refresh you on it and include some additional information. Firstly, commission

disclosure is, in my opinion, a means of the manufacturers who support this position having more control over distribution by deincentivising the process of moving business, which is the only leverage that we have. The manufacturers get bigger through merging and acquisitions. The level of service is diminished to the advisers, who are their clients, which has a flow-on effect to our clients, who are your constituents. We are seeing the reduction of service daily by major institutions, and this is flowing through to us. We need to maintain the status quo to provide a satisfactory level of service to clients, to provide training to recruits and other staff—which has fallen on us—and to retain some leverage against these powerful manufacturers. We have become an administrative facility, not a sales operation.

The major services we provide are establishing clients on risk, which is becoming very difficult; making sure they stay on risk, because the administrative procedures of the bigger companies are falling away; and, finally, assisting with claims, which is becoming mandatory because of the extreme position taken by the manufacturers. I have included some examples in the original submission. I should add that I had a client ring on Friday night who injured her shoulder. She is a physiotherapist and she has been asked for a full seven years of medical records before they will even process the claim.

The next thing we have to look at is this change in agents-principal arrangements and the agents' right to work. Joe alluded to this. In my situation there are two issues, which I spoke of before. Firstly, if a dealer fails—it has not happened as yet; but we did not have a major insurer go broke until recently—what rights do advisers have in the event of the failure of one of these dealer groups? Secondly, what options are there for advisers should they be in conflict with their dealer and need to move on and not find an appropriate dealer? Neither has been addressed adequately in the proposed bill in its current form. In both circumstances, the adviser has not been given any consideration. In spite of what ASIC have assumed, many advisers will not become dealers in their own right because of the liability issues, which should concern this committee as far as consumer protection is concerned, and because of the compliance requirements. I refer to my summary on page 9 of the original submission—that being: who owns the majority of the dealers and how many of these dealers can survive before succumbing to takeover because of the compliance regime we are now in?

What appears to be happening is becoming commonplace, and I refer to the *Weekend Australian* feature article in the 'Money' section. This is for Senator Conroy—I wish had known before I got here. The headline is 'Too Big? Too Bad. It's Ugly'. Professor Fels made a statement:

> We need stronger laws concerning misuse of market power across the board.

The proposed legislation is empowering the big end of town at the expense of small business, contrary to the sentiments of Professor Fels. Since writing the submission, I have attended two functions involving ASIC, one as a member of the Australian Institute of Company Directors, at which David Knott was the guest speaker. The second, the ASIC roadshow, was on the future environment and the requirements going forward.

Senator CONROY—Was Alan Ferguson on that roadshow?

Mr Murphy—No, it was in Adelaide. The first did not deal with the issues raised in my submission, because David Knott did not talk about it, and neither did the second. I am not sure whether ASIC have any real perspective of our place in the financial services industry or, if they do, whether they have shown any understanding of our place in the industry. I am the principal of a small business—and I am not sure for how long, a situation I would not be in if it were not for this proposed bill, or as proposed in its current form. I commenced my business 15 years ago and have built it steadily to a point where it employs five people, and none of them family. That is a comment I make relative to the issue of alienation of income, which is being dealt with by others.

At this time, I would like to address the fourth issue, that of changes in commercial values of agencies because of the bill. The business I have established has gained a capital value and has been built on agreements that have been enforceable by the buyer of last resort clause. The value is based on an asset renewal commission. On the implementation of the bill, these agreements will be forgone and so will my capital value entirely, built up over those 15 years.

There remain a couple of questions: the first is whether constitutional powers should bring about a result which takes away a benefit without any compensation being granted; secondly, there is also the aspect of unjust enrichment of the licensed dealer, which, in itself, is contrary to common law. I think these are two issues that have not been raised to this point in time. Thank you for your time. You are free to ask questions and I am grateful for being here.

Senator CONROY—I think we interrupted Mr Nowak, who was hoping to go back to his submission notes.

Mr Nowak—Before I go on, are there any more questions for Michael, because he covered a fair bit of territory there.

CHAIRMAN—Very succinctly, too.

Mr Nowak—Some of that we will be going through here. The other thing I have—I have also got a graph—is a paper put out by ASIC on the disclosure of commission. The first group did not have a clue. I have met with ASIC and I am going to put our submissions to ASIC. This is the product statement; this is what you give to your clients. I had appointments in Sydney yesterday, and when I talked about income protection for my client, I actually turned to that page and we went through all the insurance—

Senator MURRAY—Mr Nowak, for *Hansard*, we need to identify the document.

Mr Nowak—The Suncorp Security Protection Plan.

CHAIRMAN—The customer's disclosure statement, is it?

Mr Nowak—Yes. It is the CIB at the moment. That is what they call it.

CHAIRMAN—Customer information brochure.

Mr Nowak—Yes. It will be SDP later on.

Senator CONROY—How many pages is that?

Mr Nowak—It is 44 pages. The way we operate, so that you know how it is, you do fact finding and you have one interview. Then you get the information and send the recommendations. I am seeing a young lass today who saw the principal in Brisbane two weeks ago. I am writing a $600,000 shareholder protection on her, and the other partners get $1 million, because that is the way they have structured it. I have looked at the actual information of their shareholder protection. I had that first interview; then I had to go to a solicitor to make sure who does the ownership part. That young girl is 24. It is her father's company. The $600,000 policy is a $32 premium. It is only about $350; it is not big. It is not as if I am getting thousands of dollars, but I am doing a service. For the other partner, the $1 million will be about $58 because he is 31 years old. You still have to do a lot of work on that. The knowledge that you have is what they pay for.

I wrote another case yesterday and I will explain that. There was an income protection policy on a gentleman aged 54. I did not tell him the commission because at the moment he may not even get the policy because he has blood pressure problems. So we have to write to the doctor to see if I even get him through. This is how complicated it can be. You do the fact finder, then you do your presentation, then you write the business. You may tell him how much commission you get and he might say, 'I don't want the policy.' He might not even get it because he may not pass the physical. I have had four cases knocked back in the last four months because they were not up to scratch as far as their health goes.

Ms JULIE BISHOP—I do not understand the connection there. What has the fact that you have disclosed the commission got to do with the fact that he might not get it because of medical grounds?

Mr Nowak—The person might say, 'I don't want to pay that commission.' He needs that cover because he has a wife and three children. Great, another $400,000 policy—put it in superannuation through the company chequebook. If I say to him that I might get $3,000 worth of commission, he might say, 'You're getting too much commission, I don't want the protection.' If he dies two years later his wife gets nothing. That is the concern we have. It is an anticonsumer thing because I might not write the business where I should have written the business.

Ms JULIE BISHOP—Sorry, I thought you were talking about a circumstance where he gets knocked back on medical grounds.

Mr Nowak—He can get knocked back on the medical or he could—

Ms JULIE BISHOP—That has nothing to do with your commission.

Mr Nowak—Yes, it does. You do not get any commission. You do all the work and you do not get paid.

Ms JULIE BISHOP—The fact that he gets knocked back on medical grounds has nothing to do with the fact that you disclosed the commission.

Mr Nowak—No. What could happen is he could get a loading. If he gets a loading because of his health, that $258 a month income protection policy premium could cost $400. He could get accepted for the policy but get an extra loading of, say, $150 a month because the mortality rate is against him because of his blood pressure. Then I get that extra commission, but it is still a lot of work. If I start talking about commission, he might say, 'No, I don't want to pay that.' I might not even get to do the protection. It could completely ruin the process of providing the advice.

Ms JULIE BISHOP—He could have asked you that up front.

Mr Nowak—I will tell him if he does. If he says to me, 'How much are you going to earn on this?' I will tell him, although I have only been asked once in 31 years.

Ms JULIE BISHOP—Did it make any difference when you were asked?

Mr Nowak—No. I do not worry about it. I would tell him.

CHAIRMAN—Did you lose the client?

Mr Nowak—No. With the advice that we provide, the complex work we do sometimes in a business assurance partnership, they are paying for your advice. It is complicated. The way I have set this young lass up, I have to put her into a trust. If I do not do it correctly and I put it in her name and she is living with a partner for three months, he gets the money, $600,000.

Ms JULIE BISHOP—If they know they are paying you for your advice, that equates to the commission that you earn. I do not know that consumers are so unreasonable. They would say, 'I know Joe, he's been around the industry for a long time. He's got 30 years experience. Yes, I'm prepared to pay for that advice. He deserves all the commission he gets.'

Mr Nowak—What the consumers do not understand is this. Last year I had five people on claim. Four of those are for income protection. Two of them are breakdowns. My brother-in-law hurt his knee on a building site. So we do all the paperwork for the income protection. I monitor that. One of the clients unfortunately died. He had leukaemia. He fought it for a year. I went and saw him two days before he died. They rang me up on the day he died. I rang the head office at Colonial. They sent me the three months cheque in the mail the next day and I dropped it to the widow at the funeral. That is what I do. I deliver the cheques. No-one ever talks about our service work. That is the most important thing. I have delivered a lot of cheques in my 31 years for death claims, disability claims and other situations. They do not talk about that service work. What you are paid for is to look after the client through the next 10 years or 20 years. I have policies that have been in force for 25 years and I look after them.

Ms JULIE BISHOP—Is your concern that if clients are told about your commission they are not going to see you being deserving of it?

Mr Nowak—No. Sometimes if you do not know the person you do not have that relationship. If you get what we call a referral, a new client, and he does not know you well, it could become a hindrance to the process because you do not get to the sales process sometimes until the third meeting. You do have to have a first interview fact finder; then you go and make your recommendations. But you might meet with two other people, and it might not be until the third meeting that you go to make the sale. It is a long process. Sometimes it takes two or three months to make a sale. You do not just sit down with someone and say, 'Here's the deal.' With this young girl I am seeing today I put up two company submissions and I put three different scenarios in, and they made the decision.

Mr Mitchell—We got this letter from Mr Hockey. He says in this letter something that has not been discussed here this morning.

Ms JULIE BISHOP—Which letter are you referring to?

Mr Mitchell—This one. The point is that you do not have to disclose unless there is a bias. That has not been discussed yet this morning. That is the conclusion that he has come to in this letter. This commission disclosure is getting pretty vague.

Ms JULIE BISHOP—On page 4, under the heading 'Commission disclosure requirements', it says:

The purpose of the FSRB's disclosure requirements is not to require the disclosure of 'total distribution costs'... Rather they aim to ensure that retail consumers understand any potential biases or conflicts of interest that might influence the advice they receive.

Mr Mitchell—Yes, and that favours tied agents very much because there is no bias there. The only bias in a tied agent is where he may be getting towards getting a trip overseas. If you get to that stage, I cannot really understand what commission disclosure does in a case like that. If I was talking to a client and I said, 'I have a bias here; I may be going on a trip overseas and my commission is, say, $2,500 on this,' what relevance is that to the situation? If the bias was explained, it might be sensible, but I just do not see any sense in saying, 'My commission is $2,500.' That is the up-front commission, and there is also a level commission, which my friend here has just alluded to. If you go to a level commission you can say, 'My commission is $800 or $900,' or whatever the figure is. It is lower but you get that for the rest of the life of the policy. It is irrelevant; it is not logical. I like what Senator Murray was saying about comparing the whole cost of the policy; on page 4 of this letter the minister says that, but that is not what it is about.

Mr Nowak—In the chain here, and I have spoken to ASIC about it, we want everybody who handles one of these situations in a bank or anywhere else, if he gives that information for marketing, to have a G to explain who he is—his name—and that he is competent to give that out or market it. Then the consumer knows who his first point of call is. You are happy and you can put a name on it. At the moment, the banks can just give it out to anybody without a name on it; that concerns us, because sometimes they do give advice and no-one can trace back to where it all came from. What we are saying is that, at the point of contact, whether it is marketing or whatever, there must be a guide and that person must be competent to give that advice.

Secondly, in this PDS, at the moment for the accumulation products—that is the money products—you have all your costs which you can go through and explain. I did that yesterday with my client. When I get the money I just tick it off; you have your five per cent and everything and explain that. I sign off and date it when I give that to my client and they take it so at least they know that I have done that. You then put that in the SOA. On the risk side, in the PDS there is no disclosure of commissions. We have been through that. I have to disclose it on my SOA or advice if I do that risk assurance. But if you do a one-product situation in the bank and elsewhere there is no disclosure, there is no SOA to be given to the client—it is in here. I said to ASIC, 'You're joking.'

Senator CONROY—Banks are more powerful lobbyists than insurance agents, clearly.

Mr Nowak—But this graph is so complicated, I said, 'Please explain'—Pauline Hanson.

Ms JULIE BISHOP—To coin a phrase.

Mr Nowak—Yes. If you do not do it correctly—that is what worries me—ASIC will say, 'You have not done it properly,' and I will be out of the business. Who am I going to turn to? They have a disputes resolution in three months, I am trying to pay someone to work for me, and they put you out of the business. Under the agents and brokers act, I can be put out of the business only by going to court—at least I would have a stand—but here we do not know we are going.

Mr Mitchell—That graph, by the way, comes out of one of the papers from ASIC—PPP4. There are five that we are supposed to have commented on last week, and ASIC are going ahead with the way that they are going to administer the bill, even though the bill has not been passed.

Senator CONROY—How many pages do those five documents amount to?

Mr Mitchell—About 500 or 600 pages, and they have just put out another four.

Senator CONROY—Each document or all together?

CHAIRMAN—These are policy statements you are talking about?

Mr Nowak—Yes, PPPs.

Senator CONROY—Do the new four each contain 500 pages as well?

Mr Mitchell—Yes.

Senator CONROY—Are you talking about a couple of thousand pages?

Mr Mitchell—Yes, getting that way. You might be exaggerating, but there are certainly over a thousand.

Mr Nowak—That is happening: you have the bill, you have no regulation, but you have your PPPs, which will become regulation—that is what I have been told.

Mr Mitchell—They are out for comment, but it is very difficult to comment on these things.

Mr Nowak—The sixth point is IPS 146. Our concern is that we have a two-year transition period under the FSR Bill—the alienation—and we have to structure our businesses. If the bill comes in in October or January, we will have a two-year transition with the ATO. But with competencies—the education part—they are saying, 'You have to do these courses now.' As you have said, the consumer says that the sooner we do them the better.

I am a bit concerned. I started in the industry in 1964—straight out of grade 12. I spent 6½ years in the office of Legal and General and I have been an agent since 1970. I have done a lot of work, but I am given no credit for my pre-1995 experience, knowledge and relationship. It is a great concern. I have just received the submission from Peter Driscoll. Peter Driscoll was the distribution manager for ACNL, which was the subcompany of AXA, for 10 years. He wrote a submission to ASIC about his concerns, and he said:

A good proportion of multi agents are lacking formal education, though they have a wealth of experience as advisers and self-employed business people. Insistence on formal academic training and qualifications for many might create an unreasonable barrier to their operating under their own license.

It is a great concern, because we have over our heads this two-year transition into the taxation era—the alienation—and they want us to be competent. Until last week, ASIC would not look at all the training courses that we did or the personal and business assurance courses that we did in 1984. Those courses relate to what I was talking about: the partnerships, being key man, and all that work we do. I know how to read a balance sheet—you can see whether a person or a business has liabilities, et cetera. We are given no credit for that at all. It is absolutely disgraceful. They are treating us as if we were absolute fools.

Senator CONROY—How many hours of study would you have to undertake to meet the new competency requirements?

Mr Nowak—I would have to do 40 or 50 hours, but that would be taking me out of my business. I am trying to run a business.

Senator CONROY—I understand that. You think it would be 40 or 50 hours.

Mr Nowak—That is right. A lot of the competencies that they require under the new regime are taxation and things like that, which I can get off the Internet. I do not need to study them, because they are taxation things. If I need to get that information, I just ring my accountant. If I am going into a situation of business, I will refer to it, and in these cases I will have an accountant or solicitor in there to do all that with me. If I do not know, I will go and ask them. You do that anyway—you do not say something that you do not know about.

Mr Mitchell—One of the problems is that we are changing regulators. We have gone from ISC to ASIC, and there is quite a different culture. That is acknowledged by ASIC in one of these papers in which they said, 'You need to know it to learn how we operate.' They did not

confer with us regarding the 1995 situation, yet in the paper they say, 'We have consulted extensively with the industry on this issue.' I can understand what they have done. They look at principal-agent relationships and look at the principals—that is, life companies—as being the people who know what is going on.

Mr Murphy—I have two staff members that are eminently more qualified that I am and they do not advise. If they moved forward to being advisers from being in secretarial and PA roles, the interesting thing which you may not be aware of is that, under the proposal, if they held a proper authority with a licensed dealer, they would have that authority in their own right. There is no provision for me to have any control or influence over them. In fact, in our arrangement, it would cost me, the principal of the company, a service fee of $3,000 a month or $1,000 for each one of those proper authority holders, just to hold an authority to advise. That is $36,000 a year for a software service that works 40 per cent of the time. I can tell you that I probably have more competence with my experience than some of those people who are manning their technical service desks, but I have to pay that.

Ms JULIE BISHOP—How do you suggest that previous experience be calculated as a competency?

Mr Murphy—I do not know. I believe that there are a couple of the—what are they called?

Mr Nowak—There is a challenge test by NIBA and IntegraTec.

Ms JULIE BISHOP—By whom?

Mr Nowak—IntegraTec. This is the RTO group. It is a registered training organisation. But costs are involved. There are a lot of costs. I am going to have to go through the process. I am not fighting that at all. I am saying to everybody, 'Be aware of it.' They have got one date for education, and one date for the ATO if you are a business structure. If I have to go out of business and sack people, that might have to happen.

Ms JULIE BISHOP—Your concern is the time that you have to take in order to meet the competency level rather than the fact that you have to do it?

Mr Murphy—The way they are doing the competency is that they are not geared to look at our experience, knowledge and relationship. They are not handling that part of it too well. If you did your doctorate in dentistry or medicine in 1972, they are saying it does not matter. That is their whole attitude. That is what worries us.

CHAIRMAN—What is the relevance of 1995 as a cut-off in terms of what is recognised and what is not?

Mr Mitchell—I did ask them that question and they thought it was a good date.

CHAIRMAN—There was no difference in the training that you did after 1995 compared with pre-1995?

Mr Mitchell—To be fair to ASIC, they said to me that that is the date that the taxation situation changed and also when the good advice came in.

Mr Nowak—The code of practice.

Mr Mitchell—It is not the code of practice. It is the good advice with regard to the Corporations Law. They are saying that we have got to move over to their system.

Mr Nowak—We were told through the whole process that we would not be disadvantaged and if we got through we could get on with our lives. The last issue is the capital gains liability on our business. My company has been set up since 1977. We have been asking questions about that and we have got nothing on that. So I could be back.

Mr Mitchell—That situation is created by everybody having to change their contracts.

Senator CONROY—I will defend the government here. I am sure that they are contemplating rollover relief. I do not often defend the government.

Mr Nowak—On the last one we have gone to the ATO. On the taxation side, we are trying to go through ASIC and the ATO through Senator Kemp. If you are in what we call a service advisory business like I am, and have been for 24 years now, we can have the contracts between our dealer and ourselves so that we can move to any dealer. The ATO will then recognise that as a business. We are saying that, because you are independent and you can move from dealer to dealer and look after your clients, and if you move from dealer A to dealer B, it becomes a business. It might take you six months to do it, but when you move on with your clients, you are really a business.

The next form of relationship is what we call subcontractor. This has caused a lot of problems in the industry at the moment with financial services. A lot of people in the system in the last 10 years have worked as subcontractors off a big dealer. They have not had their own office. They have not paid their own rent or had their own shingle. They have not taken any risk. However, they expect to have this company set-up. That is what has happened there. Alternatively, you could be an employee. You would work for salary and you might get a bit of commission like in the banks, et cetera. Those are three scenarios which we are working through. I do not know how we can get that into here, but we need some sort of guidance and help from you on that.

CHAIRMAN—Are there any further questions?

Senator CONROY—I have interjected all along the way, so I am out of questions.

CHAIRMAN—In relation to the issues about changes in agent-principal arrangements which you have referred to in your submissions and also changes in the commercial value of the agencies, are there particular amendments you can suggest that will overcome those problems?

Mr Nowak—I think it could be tax driven, because when we were at Minister Hockey's office and we spoke to advisers there they threw the ball to the Taxation Office.

CHAIRMAN—That does not deal with the agent-principal relationship.

Mr Nowak—It deals with contracts, though—contracts and taxation.

CHAIRMAN—There is a taxation issue attached to it, but that is not the principal problem, is it?

Mr Murphy—My concern, which I think you have picked up, Mr Chairman, is that I have a business that arguably is worth $1 million and that, if this bill goes through, is worth nothing. I am just a married bloke with six kids; and, in spite of what the consumer lobby group said, they were under six when I started in this business so I did not go out at night either—I was too busy being at home putting them to bed. You have encouraged this, Senator Conroy!

Ms JULIE BISHOP—I agree with that.

Senator MURRAY—You may think this grants you privilege, but not against your wife!

Mr Murphy—But that is a very real issue that has been overlooked in this whole thing. I am a proper authority holder now, but because for 90 per cent of my business I am a humble life insurance salesman the government wants to call me a financial planner. That is where my asset lies, with those agency agreements, which have a guaranteed buy-back.

Mr Mitchell—And those things are held in contracts with the life company, and all such contracts are presently entitled. That means that, after death, those belong to the estates. Under the Corporations Law, that is unusual. That is the way it has grown, like Topsy—the Corporations Law has grown; the agent and brokers act has grown. There is a major difference. We have asked the Financial Planners Association, who we believe represent dealers, to ask their dealers to put into their contracts present entitlements. We asked them that two months ago in a letter. We have not had a reply, and I can see why. But the fact is that under the Corporations Law the clients are owned, in effect, by the dealer. If this law goes through, all those contracts will have to be renegotiated. Mr Hockey said in this letter that he is not going to have anything to do with that part of the equation. 'You deal with that,' he said. 'You are the persons who are dealing with it.' That leaves every life agent very much disadvantaged. One should not forget that 90 per cent of dealers are owned by life companies. So what the life companies are getting is a reshuffle of the whole caboose. And guess who is winning?

Mr Murphy—Dugald, there is another thing on top of that: most of those life companies are now owned by banks. I think that should be more of a concern.

Ms JULIE BISHOP—Can you take me through that step by step and give me an example? It gives rise to an interesting legal possibility.

Senator CONROY—Mr Murphy has given an example.

Ms JULIE BISHOP—I was talking to Mr Mitchell, but either of you could—I do not mind.

Mr Murphy—Currently, my agreements are held, where my business is with life insurance companies, with a clause in them which gives me a guaranteed buyer of last resort provision. The minute the Financial Services Reform Bill comes in those contracts are forgone, because I then must become a proper authority holder of a licensed dealer or, in fact, become a licensed dealer in my own right.

Ms JULIE BISHOP—When you say that they are forgone, what do you mean?

Mr Murphy—I can no longer operate under those contracts. The legislation has—

CHAIRMAN—And you were saying that those contracts have a value?

Mr Murphy—Yes, and that has been obliterated. That is why I bring up the point. There is a constitutional law issue there.

Ms JULIE BISHOP—So what happens then? What is the next step?

Mr Murphy—The next step is that I then become a proper authority holder. I transfer the business I have that has got a guaranteed capital value to a dealer. That dealer provides me no guarantees, because I have just assigned my clients and the income stream they generate to him. So, firstly, if the dealer fails, we know what happens with trustees or with people who are appointed to look after those things: they will retain any income stream. Secondly, if for any reason that dealer decides I am not meeting their standards from the compliance perspective, they can withdraw my proper authority, and they retain the ownership of those clients.

Ms JULIE BISHOP—These agreements that are forgone do not then carry over in any other capacity at all?

Mr Murphy—In no way, shape or form.

Mr Mitchell—That is in Mr Hockey's letter.

Mr Murphy—No-one wants to deal with it. As you can probably see, I was quite impressed by the intellect of the people who went before me. I am not quite in that league, and I do not understand this. All I see is that I have something of value, and tomorrow I might have nothing, except my wife and six children.

Senator CONROY—Has your organisation been able to get some constitutional or legal advice on this?

Mr Murphy—I am very fortunate. I have about 500 of these people as clients. I was transacting some business with one of them, and when he wanted to do it this week, I said, 'I cannot do it this week; I will have to do it on Friday', and he said, 'Why?' and I told him that I was coming up here. He said, 'What are you on about?' That is the typical conversation. On the telephone, he said initially, 'There is a constitutional law issue here', and I said, 'That is terrific.' So, when I got around there and had completed my part of the business, I said, 'Can I

pick your brain?' He said, 'Yes, there are two issues.' As I have said here, one is that, if constitutional powers bring about a result which takes away a benefit—

Senator CONROY—You have the just compensation argument.

Mr Murphy—Yes. And the second one is this business of unjust enrichment of the licensed dealer. It is a common law one. What happens is that, if as a result of this I transfer my total asset base to the dealer, I need compensation. So there are issues of law. Without going into it, it was a five-minute discussion where, as a young lawyer, he said, 'That would be a fantastic case to get my teeth into.'

Ms JULIE BISHOP—Every young lawyer can find a constitutional take on every problem, I think.

Senator CONROY—*The Castle* is showing on Saturday night!

Mr Murphy—As I say, I have not looked into all these aspects in any depth. I have just looked at it from the perspective of how this is going to affect Michael Murphy, the principal of Murphy Financial Services.

Ms JULIE BISHOP—That is what I am interested in hearing about. I think you said that it had been dealt with in the minister's letter—or Mr Mitchell said that.

Mr Murphy—Yes.

Ms JULIE BISHOP—So I am just trying to clarify that.

Senator MURRAY—Let me understand the law in this. Who owns the contract?

Mr Murphy—In this case, currently, for my life insurance business, I do.

Senator MURRAY—You own the contract. So the life insurer is holding the contract in escrow for you. You own it, and you have given it to somebody else to hold in trust. Is that right?

Mr Murphy—I am not well-versed in these things, but I was on one of the federal committees with one of the life companies when we were presented with a new agreement some five or six years ago. I raised the issue that I did not see it constituting an agreement, because we had not negotiated any part of this. So we were then given the opportunity to go to another legal firm in Sydney, and they negotiated on our behalf. What we got written into that agreement—which became pretty commonplace—was a buyer of last resort guarantee. In the event of—

Senator MURRAY—You have ultimate ownership right?

Mr Murphy—Yes.

Senator MURRAY—In law that means that the person holding the contract therefore holds it in escrow for you, and you are saying that the consequence of this legislation is that you will lose your rights of ownership to which is attached a known economic value?

Mr Murphy—It would appear that way.

Ms JULIE BISHOP—And then what happens to the escrow arrangements?

Senator MURRAY—And does it shift?

Senator CONROY—And are you saying it shifts to somebody else? That is what he was saying.

Senator MURRAY—You are saying it shifts to the dealer, so it remains in escrow but the ownership is shifting from you to the dealer or the licensed authority. Is that what you are saying?

Mr Murphy—Yes. ASIC seems to have the impression that all life insurance agents are going to rush out and become dealers, because you can retain that by becoming your own licensed securities dealer. I think the implications of that are pretty horrendous for the consumer. I would not like to expose myself to the liability that goes with being a licensed securities dealer—or expose my clients to that in the event of me failing in any way.

Mr Mitchell—And, on that point, you could say the requirements of ASIC are harsh so far as dealers are concerned, but they are very strong.

CHAIRMAN—They are stringent.

Mr Mitchell—And they are quite different from being a life agent. You have got to put sureties up, as well as other things—which is not necessary now.

CHAIRMAN—At this stage, do you have a suggested amendment that will remove this problem?

Mr Mitchell—I do not think the bill should go through, quite frankly, because of this. I do not think it is intended in any way—it is an unintended consequence.

CHAIRMAN—Yes.

Ms JULIE BISHOP—You could end up throwing the baby out with the bathwater.

Mr Murphy—I think an unintended consequence is a good term. You could defer on a couple of these issues. I agree in principle with the bill, as I said in my first submission. This is a minuscule part of it, but I think because it is so minuscule it has been overlooked by a lot of people. If you look at the history—which I think it is important for the committee to know—two or three years ago, as the life companies wanted to move towards this new platform, they were pretty forceful in shifting advisers across, and carrots were offered. There was remuneration for shifting into this new environment. I refused to accept that, because I did not

shifting into this new environment. I refused to accept that, because I did not think it was quite in the interests of my clients. I wanted to see the outcome of the bill. Now that we see the potential outcome of the bill, I find I really made the wrong choice, but I think my clients still have the same relationship with me as they had before, but I do not know how we will go. I have just written to all of them and said that, going into this next period, we may have to enter into a different relationship. I do not know what that is, but it is going to be different.

Ms JULIE BISHOP—You are saying that the only way you can see around it at this stage, for those agreements to continue, is for you to be a licensed dealer?

Mr Murphy—Yes. In fact, I would retain equity.

Senator CONROY—But there are enormous costs in terms of liability, possibly, and even in—as I think you described—that $36,000. Would that come into play in this circumstance at all?

Mr Murphy—No, it would not. That is just an aside that you started me on. What would happen is that we would then, as licensed securities dealers, be subjected to a completely different regime in terms of the way we would have to operate, in terms of securities—

Ms JULIE BISHOP—You would have completely different—

Mr Murphy—Competencies, compliance standards and all of those things that are currently provided by licensed dealers.

Ms JULIE BISHOP—There is a far greater range of opportunities available to you, though, is there not, in terms of the products you can sell?

Senator MURRAY—You are being incentivised!

Mr Murphy—Not at all. I think the difficulty there is that—and that is the point I made—as we go forward, how many licensed securities dealers will not be owned by banks? How long will it be before those licensed securities dealers are on their knees waiting to be taken over? You just could not anticipate the cost of compliance as required by this bill. It is as simple as that.

Mr Nowak—As Michael has said, Peter Driscoll makes the comment that he estimates that in the transition period about 10 per cent will become licensees as they go through the process of the enormous cost of setting it up. There is also the fact that with compliance and everything you can only work, say, 10 hours a day, and our main task is as a service and advice area, but if you take yourself out of there and you have got these other tasks to make sure your company runs, you will lose your whole business or your empathy for what we are really about—we are practitioners; we do not want to be administrators. That is the problem we have.

Ms JULIE BISHOP—Changing the subject, and picking up on something that I think Mr Morgan said: given the collective experience at the table here, can you comment on whether there is really much difference in the amount of commission for various products? Are we really

talking about a lot of money? If you are putting up different products for a client, are there enormous differences in the commission that you can gain from one to the other?

Mr Murphy—No. I was going to say, 'Why do you ask?'

Ms JULIE BISHOP—I ask because I want to know what we are dealing with here.

CHAIRMAN—What the effect of disclosure is—is it—

Ms JULIE BISHOP—I am talking about what the effect of the disclosure is. Are we talking about $1,000 compared to $100,000 or are we talking about $1,000 compared to $1,200?

Mr Murphy—On the disclosure issue, I think that if you are looking on the basis of providing advice product for product, then commission rates are the same. There are three ways that that commission is paid. It can be paid up front, which is my preferred option. It can be paid, in some cases, as level commission, which is where the big end of town is trying to drive it. The variance there can be from, say, 80 per cent of the initial first year's premium down to 20 per cent per annum on a rolling 20 per cent premium. The 80 per cent would then reduce to between five and 10 per cent as a renewal commission. From where I run my business—

Ms JULIE BISHOP—You said there were three. What was the third?

Mr Murphy—The third one would be a hybrid. You would pick somewhere in the middle, where you would pay, say, 50 per cent in the first year, then 15 per cent, 30 per cent, 10 per cent, 10 per cent, 10 per cent and so on. We have already gone through, from our business perspective, going away from the investment product where there were margins in time that you could use to run your business. Now we may be further impacted with the same thing on risk commission. The difficulty I have in my practice is that my training time is enormous because I am recruiting and growing, there is no doubt about it. So we do need that initial slug of commission. It also assists in structuring remuneration packages for staff. If you are on a level commission and they go, you are back starting all over again. I have just had an associate leave after five years, purely because she and her husband got offered a job to manage a convention complex. I suffered the consequences of not employing the principal breadwinner. So now we are back to the training all over again.

Ms JULIE BISHOP—Careful!

Mr Murphy—That was the simple fact. It was as simple as that. And she went with our blessing.

Mr Nowak—I have got two quotes there for Jacqueline, the lass I am seeing this afternoon. On a $636,800 policy, it is a $32.51 per month premium if I did it with Colonial and a $35.42 premium if I did it with Suncorp Metway.

Ms JULIE BISHOP—You are talking about a couple of bucks difference.

Mr Nowak—In that premium, yes. But if she chose to go for the lesser premium, I would get less commission. It is only a death policy, so the benefits are the same, and the difference in premiums was $3. I do not even know the commission rates, because that is not an issue. I give them the choice and they tell me which policy they want. That is how this one is done. I always give them choices. I work from four and I give them two choices. It depends on what product it is, because with some products, if you are doing a trace person, some companies have a better rate and better claims—Daryl spoke about that before—so you know where the underwriting is and you know where the best situation would be. So you have got to try and get that person through and in place. That is the big concern. You are not really concerned about the commission so much; it is mainly getting the business placed.

Mr Murphy—I think in response to that question, if we go to a level commission, then in our situation we would probably have to go and borrow. Where do we go and borrow from? We go to the people that are driving the agenda. The banks own the life companies, so we are just putting more money into their hands. Also, a life insurance agency that is going to be worth nothing in a few months time if this bill goes through is not very good security to lend on. So there are a lot of issues. On the commission thing, I said in my submission that disclosure does not impact on my client base. It has never been an issue. But I do not think that that is a reason for it to be introduced. It is quite simply that. To go back to what Senator Murray said earlier—this business of a bottle of wine, a suit of clothes, or a BMW or a tractor—I am sure Mr Hugo Boss comes to town and says, 'We will give you of bottle of Moet for every extra suit you sell,' but does that mean that you get half a bottle of Moet with every Hugo Boss suit? That is the extreme that it can go to.

Mr Mitchell—Can I just say one last thing? We have got small businesses in the industry that are very much under stress. We have got this bill, the competencies—the IPS 146—the GST and the alienation of income. Those are four things which are really putting a great deal of stress on small businesses. If this continues, I think we will lose a lot of people—they will get sick of it—and I think that is a pity.

Senator CONROY—Why does this government hate small business so much?

Mr Mitchell—It is a mystery to me.

CHAIRMAN—We do not need gratuitous remarks, Senator Conroy. I thank each of you for your appearance before the committee and the extensive way in which you have responded to our questions. It has been very helpful.

[12.40 p.m.]

FRENCH, Mr Philip Gardner, Senior Policy Manager, Investment and Financial Services Association

RALPH, Miss Lynn Susan, Chief Executive Officer, Investment and Financial Services Association

CHAIRMAN—Welcome. We have before us your submission which we have numbered No. 29. Are there any amendments to make to that submission?

Miss Ralph—No.

CHAIRMAN—If you wish to make an opening submission, please do so and then we will proceed to questions.

Miss Ralph—This bill has had a very long gestation and I think many of us in the room today have followed that gestation with great interest. It has come a long way over a number of years. Certainly I can think back to the consultation over the Wallis inquiry before the Wallis inquiry report was tabled. It is an important bill because, unlike a lot of legislation, which is often in reaction to some sort of failure in the market or failure in the system, this bill was about looking forward and about trying to ensure that we had a regime that would enable our industry and our consumers to thrive over the next couple of decades.

In that respect, it is an unusual bill. Because of that it has not been readily apparent to a lot of participants in the marketplace that we needed a bill. There was not a crisis that they could see this bill was directly addressing. It has had a long gestation. There have been enormous phases of consultation prior to the bill's being drafted, with several discussion papers coming out of Treasury. It is not surprising to us that our members within our industry generally support this bill, have known for a long time it is coming, and have seen the form and the shape of it for a long time. Having said that, it is quite a comprehensive bill. It is necessarily a complex bill. It does go to the heart of the business of how we interact with our customers on a day-to-day basis, as it should. It is not surprising that you have something like 70 submissions—a myriad of submissions—going to a lot of issues that are raised in this bill, including our submission where we raise a number of what we think are important, but not necessarily core, issues in the bill.

I just want to say in my opening remarks that the issues we raise in our submission do not affect our overall support for the bill and its objectives, which we believe are to build a strong, consistent and comprehensive regime for consumer protection in financial services regardless of who the provider of those services is. We definitely support that goal and we think the bill by and large achieves those objectives.

In addition to the points that our submission raises, we understand that in the submission from the International Banking and Securities Association, known as IBSA, they raise the issue of telephoning during takeovers, and I would just like to say that IFSA generally supports the comments made in the IBSA submission in relation to telephoning and takeovers. Thank you very much for allowing us to appear today. We are happy to take your questions.

CHAIRMAN—You raised the issue of director disclosure regimes in your submission, and in particular the proposal announced by the Australian Conservation Foundation advocating that additional requirements be included in the PDS in regard to environmental, social and ethical considerations. Could you enlarge on your difficulty with that proposal?

Miss Ralph—Our industry has been living under several different disclosure regimes, so we have experience in at least three different regimes for disclosure covering managed investments under Corporations Law, life insurance and superannuation. It took our industry some time to come to grips with how we thought disclosure should go in the future and what sort of regime we should have. Having spent a lot of time thinking about it, we came to support the directed disclosure regime which sits in the bill today. We spent a lot of time thinking about what points or directions should be included in the bill. Having said that, because of the wide range of products to be covered by the bill, we felt that the sort of direction which exists in the bill as it stands is sufficient for people to operate under. It covers the key issues that people need to know about when making investment and financial services product decisions, and we felt that it was best left, at that point, for the providers to then fit their products into that regime.

We have some concern about starting to layer additional issues into that disclosure regime: either in the bill, in the regulations or—dare I even say it—in ASIC policy. This is because we would start to go back towards some of the prescriptive regimes that we currently operate under, about which we have had poor feedback from consumers in relation to some of the existing prescribed disclosures, for example, under the SIS Act. We feel that to start to get into layering specific areas of disclosure requirements within the actual bill is probably inappropriate. We can then get into whether or not we think the particular proposal by the Australian Conservation Foundation is a good one or a bad one, what the purpose of that proposal is, whether it is in fact to try to drive investment manager behaviour to further adopt various screening techniques or whether it is purely to allow the consumers to distinguish what screening techniques are in the marketplace already.

Investment managers who use particular social or environmental screening techniques scream very loudly about it in their disclosure documents and see it as a selling point for those particular products. Therefore, that is happening already. For managers who do not necessarily use those particular types of screening techniques in their investment strategies, I am not sure that this disclosure requirement would actually push them in that direction. I am a little bit confused about what the objective of the amendment would be, as well as about how people would actually comply with it. Investment managers who currently use those sorts of screening techniques would obviously go into quite an amount of detail and would elaborate on the techniques because it is a core part of the investment strategy of that product. Investment managers who necessarily do not adopt that style of investment strategy could comply with the law by making quite general statements about how they screen companies for their legal compliance or whatever. I am not sure that that would necessarily provide investors with useful information. In fact, it could even work against those funds that do heavy screening in this area because it would be more difficult for consumers to distinguish one fund from the other if everyone had something under that paragraph in their PDS.

To summarise, we think that the directed disclosure regime, as it stands, is sufficient in the bill. We do not think that starting to layer specific requirements for disclosure is a sensible policy idea, and we have some trouble understanding exactly what the proposed amendment is

trying to achieve and some concerns about whether it would in fact achieve any of those goals, anyway.

CHAIRMAN—The other major issue you raise is in relation to superannuation products and the fact that there are wholesale products which should be recognised as such. Could you perhaps distinguish, in a bit more detail than you have done in your submission, where you see the line being drawn and how it should be drawn?

Mr French—We have a professional investor test in the law now. Why not adopt that for superannuation purposes? It will pick up such people as trustees and others who control significant funds, and so on, who are genuinely wholesale. I do not think that to do that endangers retail consumers at all. This is framed a bit too broadly and it would appear to be an oversight. The $500,000 limit that we have referred to is another issue. It does not come anywhere near a professional investor. It is just to pick up things like pooled superannuation trusts—that is all—because they are, under this, going to have to be treated as retail.

Miss Ralph—There is a clear wholesale and retail market in superannuation; it has been operating that way for many years. We have trouble seeing why you would apply what is basically a set of retail consumer protections into the wholesale market arena, which has been operating effectively for a number of years. There is quite a distinct line—people know where the wholesale and retail line is. We are unclear on the justification for suddenly including that wholesale superannuation market into the retail protections.

CHAIRMAN—Have you had the opportunity to examine ASIC's policy statements that have been released recently in anticipation of the passing of the bill? If so, have you any comments on them?

Miss Ralph—There are proposed policy papers; they are out there as discussion papers. So the first thing is that we do not actually look at them as policy statements. They are discussion papers that have been put out to try to draw out a fair number of the more detailed issues for implementing the bill. Obviously our industry and our members have been through those policy proposal papers—the first set has been released—and we have provided detailed commentary back to ASIC, not only in writing, but through the chance ASIC has given us to do face-to-face, quite extensive consultation on the detail in those papers. We are now starting to work on the next set.

We would expect that when the draft policy comes out there will be significant alterations from what were in those PPPs, based on the consultation that we have had. In some areas we agreed with them, in some areas we disagreed with them. It is fair to say that, in some cases, they intentionally wrote the papers perhaps in a slightly provocative way to try to draw out some of the more challenging issues and how people want the marketplace to work. We have a reasonably positive relationship with them and we worked through those issues in a positive way. All of us are still working in a little bit of a vacuum because we are waiting for the final bill and the regulations, et cetera. But one would presume that some of the basic principles of the bill will remain the same and that we can start to progress the discussions towards implementation with ASIC.

Mr French—ASIC has made it very clear that there is no tyranny of the draft intended here, that they really do want the feedback to make the final versions or the next drafts better still in terms of implementing legislation. So we have tried to match them page for page with comments because they have said, 'Please give us the comments, we really want them.'

Miss Ralph—I give them some credit on this. The bill is quite comprehensive, and where does one start in looking at implementation? Months ago ASIC came to us and asked our opinion for priorities for them in issuing policy statements and in what order. They have even taken account of which issues we would like to talk to them about first and which were the most important versus which issues we can wait until much later in the year to talk to them about. We feel we have had a good and open consultation period. As Philip said, they have put those papers out in the spirit of consultation and have also acknowledged at the beginning of all those papers that the bill is not final. So it is all subject to where we end up.

Senator MURRAY—I have to leave at 1, unfortunately, for a meeting. Miss Ralph, the product which the consumer buys has a number of profit takers within it. One of the questions I have pursued today is whether this disclosure regime is too limited because only one set of profit takers are being required to disclose their margin, which is their commission, whereas other profit takers who participate in the product do not. If part of this process is intended to influence price—it has other purposes, I understand that—do you think that there is too limited disclosure within the bill rather than too much?

Miss Ralph—Our starting point is that there should be full disclosure. We appreciate that there are going to be instances where that disclosure may not have a lot of meaning to consumers or that consumers may choose to disregard those disclosures because price at that point is not a key factor in the decision making process, for whatever reason. I suspect we probably all do not yet know enough about how consumers incorporate price into the decision making process when they buy a range of financial services; and it could possibly be different for different products and services as well. Certainly IFSA is making attempts this year to try to understand a bit more how consumers take price into account when they make a purchase or an ongoing investment decision for our products. Having said that, we think consumers will have increased confidence in the industry if they think nothing is hidden.

Senator MURRAY—Just dealing with the price issue alone, the case being put to us by numbers of submitters is that the consequence of disclosure will be for those whose profit is therefore disclosed, in the gross sense of profit, their margin, then there will be price pressure on them. Typically, that is regarded as a good thing in economic terms. However, that is not where the bulk of profit is made, it seems, with regard to products. I simply ask whether it is appropriate that it is just at the retail end where the disclosure is going to lie, or whether it should also be at wholesale and, in fact, producer end—in other words, that every aspect of the margin be disclosed? That is quite a different perspective, but it does concern me that it is the little people in the industry who most of all, in numbers, will be affected by disclosure.

Miss Ralph—I may not be understanding exactly what you are getting at because certainly our members, who could be considered manufacturers, disclose their fees and charges, they have for many years and they continue to do so and are happy to do that. IFSA has a standard for the calculation of those charges so that they are standardised when they are disclosed to

consumers. Over the years it probably has resulted in pressure on prices, which, as you say, is a good thing. But I may be a little bit confused about what you are speaking of.

Senator MURRAY—We have been told that agents, people who are out there as brokers, as advisers, are going to be disclosing commissions as the provider of the product, but the profit component in that margin which does not relate to them but relates to the supplier of the product will not be disclosed.

Miss Ralph—But isn't the purpose of the disclosure of the commission to flag to the consumer whether, in fact, any bias sits in the advice that is being given to them? That is the purpose of the disclosure.

Senator MURRAY—That is one part of it. I perfectly well understand that intention. That is why in my question I distinguished between price and competition effects and the intention to attack bias. We are all supporters of the need to make sure that bias is exposed as far as possible.

Mr French—I really do not think that is the case, Senator—I think the issue is change, not disclosure. I do not think you will hear the Financial Planning Association, for example, make that point at all. They would be good people to address the question to because they come at it from exactly the same perspective as people who are selling to individuals in the marketplace. In terms of fees, as Lynn says, our members disclose their fees, and will have to in product disclosure statements, where they affect what the consumer gets back in that product. That is all you can put in a PDS. The next level in the financial services guide is that you have to describe who is remunerated and on what basis. And when you actually give advice to a person and say, 'Hey, buy that one,' then, because there is a motive there to sell that particular product, you must disclose the exact amount of your commission.

Senator MURRAY—In both of your answers, you make the very point that I am searching for. You are actually supporting the full disclosure of fees in any circumstances where part of a fee, as I call it—the profit, or margin—is not disclosed. In your answer, I understand your view is that it should be disclosed. Could I get it on the *Hansard* that that is correct?

Miss Ralph—Could I perhaps rephrase what I think we are trying to say.

Senator MURRAY—He has just given an answer. Are you overriding it?

Miss Ralph—No. He has talked about the disclosure that is currently going on in the marketplace. Your point is about how that affects pricing—not whether or not there should be disclosure but whether or not there is some impact therefore on pricing in the marketplace. I think to presume that disclosure of prices—whether it be managed funds, a managed expense ratio or a commission on a risk product—is the only driver of pricing in the marketplace is overly simplistic. If you actually look at what goes on in this marketplace—

Senator MURRAY—No, I have not said that.

Miss Ralph—Yes, I know. What I am saying is that I think a much stronger driver of pricing in the marketplace is the fact that, by and large, we are overly populated by manufacturers and

underpopulated by distributors. Distributors have very strong market power in terms of pricing in relation to their section of the value chain. I suspect that that will not necessarily be affected by whether or not their commissions are disclosed to the end consumer at the end of the day. So I think the actual drivers of who gets what share of profit along the value chain is quite a complex series of factors. My suspicion is that the disclosure to the end consumer at the end of the day of those is only one, and possibly not even the strongest, factor in the equation.

Senator MURRAY—But you do not oppose the disclosure of those fees or margins?

Miss Ralph—No.

Senator MURRAY—That is what I want to know.

CHAIRMAN—Right along the chain.

Miss Ralph—And we do that.

Senator MURRAY—That is exactly what I was after.

Senator GIBSON—What about the risk products—

Miss Ralph—As I said in my opening remarks when we started talking about fees, I think the disclosure will be of a variety of usefulnesses to the consumer. I know that some of the arguments put forward in this regard go to the disclosure of commissions on risk products not being a useful piece of information to the consumer. I guess if I were a consumer, I would be saying, 'If there's nothing wrong, why won't you tell me?' In this regard, our conclusion is that it is better to disclose all to show the consumers that we have absolutely nothing to hide than to say, 'You wouldn't understand it. It really doesn't make any difference to you, so don't worry about it.' If we had the complete trust of our consumers in our industry that would be great, but I think maybe we would like to see even more trust in our industry, and we think full disclosure might get us there.

CHAIRMAN—So with the risk products, you would also support disclosure at every link in the chain?

Mr French—Yes.

CHAIRMAN—And the profit margins by the product—

Miss Ralph—When you say 'profit margins', I am not quite clear what you are actually talking about because we are not actually asking the agent to disclose his profit margin.

Senator CONROY—The agents were putting to us that by disclosing commission, in actual fact what was being disclosed was gross profit margin, and that was what they believed was going to be revealed as part of this.

Mr French—I do not think it is gross, is it? I think it is what you reasonably need to disclose in terms of influencing your consumer—

CHAIRMAN—Their gross income as distinct from their net income.

Mr French—So there is a carve-out there for things that do not act as an incentive to sell that product.

Senator CONROY—Not in all of their documents that are required, I think. Certainly, in one of them, that is the case but, in one of the others, I think they actually require it.

CHAIRMAN—The SOA has to provide it.

Mr French—Yes, so that is not gross, is it?

CHAIRMAN—Yes, it is gross.

Senator CONROY—In a way the agents and brokers are saying that they believe that to be a gross position.

Miss Ralph—It is an important point and I would like to make sure our position is clear. In summary, what we support is the disclosure of any remuneration and benefits which can go to influencing the consumer in the selection of products that are advised or whatever, and can effectively create conflicts of interest. That is what we are really trying to achieve in the disclosure here of these amounts.

Senator CONROY—The problem that we are trying to get to, Grant, is that the gross includes both a part that would go to influence and a part that would not. The problem in finding a way to decouple those two is that it would, I guess, require virtually a complete restructure of the industry in the way they do business.

CHAIRMAN—I think the issue that Senator Murray is getting to in terms of the agent is that his commission effectively is his total margin, but the other margins up the chain are not required to be disclosed. As you said, only certain fees and so on are disclosed, but not the margin.

Miss Ralph—But the other margins up the chain are not influencing or trying to influence the consumer to buy a particular product over another one. Our position is that what we want disclosed is any remuneration, benefit, et cetera, that goes to inducing someone to sell one product over another, so that the consumer can see the influences of that remuneration on the advice that they are receiving and they can make a judgment about whether or not the advice they are receiving has been influenced by that remuneration that is received. If you say, 'You should disclose all the profits up the chain,' then the question is: where up the chain would people be influenced? People need to know in total what they are being charged for a product, and in that respect we have no problem. But I guess the question of what value it is—

Senator CONROY—Are you suggesting that the profit margin further up the chain—from AMP, for instance—does not influence the total cost that the consumer is paying?

Miss Ralph—No, I am not saying that. What I am saying is that whether company X makes 15 per cent margin and company Y makes 17 per cent margin is not influencing or being used to try to influence the consumer to buy one product or another—in other words, it is not going to conflicts.

Senator CONROY—It might not be, but the consumer may want to know.

Miss Ralph—The consumer wants to know the cost of the product to them.

CHAIRMAN—That is the same point that the agents are making.

Senator CONROY—Yes, we have gone in a circle here and ended up back at the status quo, which is no disclosure for anybody.

Miss Ralph—The consumer wants to know two things: the cost of the product to them and whether or not the people getting paid along the chain are being paid in such a way that the advice they are receiving has somehow been influenced by that. The two things I need to know are: what it is going to cost me and whether or not the person who is trying to sell me this thing has been influenced or not. That is what I think people want to know.

CHAIRMAN—But is knowing the quantum of the commission going to allow the consumer to know whether the agent was influenced or not? It may be a wrong assumption to assume that because one commission was higher than the other that was the influencing factor.

Miss Ralph—Well, let the consumer ask the question and let the agent explain it to them. At least the consumer has confidence then that they have not been sold something because it is in the interests of the agent as opposed to being in the interests of the customer.

Ms JULIE BISHOP—The evidence we have had from so many agents has been that they are rarely, if ever, asked the commission. You say there are two vital factors they must know. The consumers do not seem to realise that is something they must know.

Miss Ralph—I suppose you could also ask the consumers how they would rank life insurance and life insurance agents on a scale of trust from one to 10.

Ms JULIE BISHOP—I can tell you where they would put federal politicians! I do not know about agents.

Miss Ralph—My opinion is that we still would not rate very highly.

Ms JULIE BISHOP—I do not know about that. I have seen some polls. There was a *Bulletin* Morgan poll—

Senator CONROY—They are above politicians.

Ms JULIE BISHOP—Are they above lawyers? I ask that advisedly, because in the most recent *Bulletin* Morgan poll about professions in whom you place the most trust in terms of honesty and ethics, lawyers were there at 34 per cent.

Mr French—That is why lawyers are now required to disclose their fees in the most phenomenal detail—for that very reason.

Ms JULIE BISHOP—This is a recent poll, so I do think that they have been scooting up the pop charts as a result. I am just interested in why we believe it is in the interests of the consumer to know this detail of commission if, on the evidence, the consumers (a) do not ask for it and (b) are perfectly entitled to ask for it and would be told should it matter to them.

Miss Ralph—You presume that everyone is assertive enough to actually ask.

Ms JULIE BISHOP—If it matters to them and it is going to determine their choice.

Miss Ralph—Why should the industry not be open and say, 'We have nothing to hide, we are an open book. We don't want you ever to think we've done something that is not in your interests, so we show you everything'? I concur. I do not think every consumer walks into an agent and says, 'Can you tell me what your commissions are?' in the first five minutes of the conversation, if ever. It does not mean they do not go home and have their own suspicions or form their own perceptions or opinions. I think most consumers accept that people need to be paid and paid fairly for a service. It may be in fact that the consumer does not care exactly what the percentage is or exactly what the dollar is. But I think it is important for us as an industry to say, 'You can trust us because we have nothing to hide and we are an open book.' Whether or not you care about it, whether it is 28 per cent or two per cent, we are at least honest enough to say, 'This is how we operate and there's nothing hidden.'

Ms JULIE BISHOP—Given that the cost to the consumer will be the same, and it is only the commission that is different, do you think that consumers will actually change their minds and opt for a different product because they know their dear friend, their agent, is going to get more money out of product B than product A? Do you think that that fact will make them change their minds?

Miss Ralph—I do not think that consumers are a homogenous group at all.

Ms JULIE BISHOP—We are treating them as such, though, aren't we?

Miss Ralph—We will all behave quite differently in the face of such disclosures.

Mr French—I do not think they would. Back in the late 1980s and early 1990s, when financial planners were putting people into the managed investment products or prescribed interest schemes, as they then were—property trusts in particular—on the basis of who was paying the best commission, consumers did not know that; they did not know why they were being put in. The real reason, in many cases, that they were being put into a product was that it was commission driven. That is why the financial planners, in order to drag that industry up over the last six, seven or eight years, have embraced full disclosure of commission. They want that confidence from their clients, to know exactly what is operating with them as sellers of

products which profoundly influence people's financial wellbeing—sometimes for the rest of their lives, if it is a superannuation product.

Ms JULIE BISHOP—So you would agree with me—I put this proposition earlier and it was rejected—that, given the current climate and given the current scenario with the collapse of HIH, and I am not saying that one equates to the other, the fact is that the industry is going to be very much under the microscope over the next couple of months, years or however long a royal commission takes. It is counterproductive for the industry to be arguing against disclosure or greater transparency at this time.

Miss Ralph—Personally I do not think HIH necessarily has anything to do with it. All of you know probably better than all of us that transparency in everything is a real issue for the community today.

Ms JULIE BISHOP—You do not think it is a greater issue for the insurance industry at this point?

Miss Ralph—I think it is an issue that has been coming for a number of years to our industry. The trend has been there and I think the trend is continuing. The HIH thing may or may not increase the focus but I think for us transparency has been an ever increasing issue. As consumers treat all of their professionals with more scepticism and want more transparency about their relationships either with their lawyers or their doctors, they now have access to their own files, which they never had before. There is a level of transparency that the community is demanding of people like you as well as us. We see that as an ongoing trend where our industry is not necessarily singled out for that sort of scrutiny, but forms part of that trend. We are being good investment managers. We always say that the trend is your friend, stick with the trend—accept it and do not try to fight it. I think we have all accepted that transparency is a real driver for the community. It is an issue that is here to stay. It is only going to get stronger and we should get on the bandwagon now.

Ms JULIE BISHOP—I like that: the trend is your friend. I will write that down.

CHAIRMAN—I thought counter-cycling all investment was the best.

Miss Ralph—That is free investment advice but, I am sorry, I am not licensed to give investment advice.

Senator CONROY—I am wondering if either of you would like to comment on the evidence from the witnesses prior to you about the question of contracts and passing across. Mr French, I think you were here during that evidence; Miss Ralph, you may not have been here for all of it. Do you have any view on that evidence?

Miss Ralph—We have not specifically taken advice on whether or not there are constitutional issues, so I certainly do not want to make a comment on that. From our industry's perspective, we have always understood that major changes in regulation of the industry inevitably lead to some forms of restructure of one's business. Whether it was the MIA, or whether it is privacy or the FSR, we have accepted that when the regulations change in a substantial fashion that does have impact on your business and often on the structure of your

business. It is fair to say that, even in anticipation of FSR, the market has been looking at how it structures its business. Many players have already made moves to restructure their businesses in anticipation. We have probably always presumed that, as part of that restructure, many distributors would face the choice of moving either under a dealer's licence or securing a licence for themselves, and that that choice would have to be made by those individuals. But, given the view that we are overproducted and underdistributed in this country, distributors are in a reasonable position when they move from dealer to dealer to negotiate arrangements that suit them commercially; and that could include recognition for value of business being brought across, et cetera.

We have always seen that, yes, there would be reorganisation, that some of that would be structural in nature and that, once we knew what structure we were moving to, people would start to negotiate arrangements around that. At least under this bill people are given a choice about whether or not they want to move into a dealer's licence and take on the obligations, liabilities and the costs that go with that, or whether they are happy to sit in an authorised representative role in some capacity, in which case there is a myriad of dealers they can negotiate the best arrangement to do that with. I understand that the competition can be fierce for good distributors in the marketplace. As I said, I am not an expert on whether or not there are constitutional issues. It is fair to say we have always known there would be change and that people's businesses would be affected by a regulatory change, but that happens every time there is a big change in regulation.

Senator CONROY—I am not a lawyer, so I always give that qualification when I start these discussions. The argument that Mr Murphy put was that he has an existing legal right and that, albeit he ends up with a choice—as you have described—to go down X or Y path from his current situation, he does not have the capacity to do nothing and stay in his existing structure and continue trading. He argues that he is being forced to make a choice between X or Y and that, under either of those paths, his existing legal right has been removed. I would understand if you said, 'You can go down here or down here, it is your free choice, or you can stay where you are.' But when you are told that you do not have a choice to stay where you are, you have to go down X or Y, there is a loss of a legal right there. I appreciate that you said you do not want to make a constitutional comment. Mr French, are you able to? Are you a lawyer? Are you able to help us here?

Miss Ralph—That is a hard legal question that better lawyers than either Philip or I should answer for you. I would not want to give layman's advice.

Senator CONROY—Mr French is champing at the bit there.

Mr French—All I was going to say was that I cannot see it. That is not to say that it is not there. But isn't the argument really that every time government ups the ante with conduct and regulation in any industry that does force change. I think it is a long bow to say that is expropriation, but I would want to see the legal advice about the constitutional issue. I will certainly check it out.

Senator CONROY—All I can say is: don't look behind you, and don't go out that door, go out that one!

Miss Ralph—We also know there are tax consequences of these sorts of changes. We have been in discussions with Treasury, the minister's office and the ATO in relation to a range of tax issues that flow out of these changes, similar to when MIA was enacted and trusts were resettled and we had CGT issues and state stamp study issues. One by one those were all resolved as well. We acknowledge that there are tax consequences here and we are working with the various departments to try to work through all those issues.

Senator CONROY—Turning to some of the more specific provisions of the bill, which I think you are indicating at this stage you are supporting, other than the issues you have raised, the FSR Bill will amend the market offence provisions. Do you have any concerns with several of the market offence provisions, including the continuous disclosure regime and the insider trading provisions becoming civil penalty provisions?

Miss Ralph—I have to say generally, as the market provisions are structured there, our members have not raised substantive objections to those. That is not to say that when they wake up on the first day they will not say, 'How did this happen?', which is common of course. We have not had from members substantive comment back on the market provisions. We have decided, internally, to have one more look at them because generally, as this bill has been discussed, debated and consulted, we have focused mostly on the licensing and disclosure aspects and less so on the market provisions. We have decided in-house to have one more look. At this point in time I think there is nothing substantive to comment on, other than that telephone and takeovers issue.

Senator CONROY—In relation to the insider trading provisions, there is some change in the wording of that provision from what the insider ought reasonably to know is reckless as to whether the information is not generally available. Do you think that this will affect ASIC's powers to enforce this provision?

Mr French—That is a tough one, off the top of the head. I was not aware of that change. It is a higher bar, isn't it?

Senator CONROY—Yes, no-one is going to get over it. It is hard enough to get anyone on continuous disclosure now.

Mr French—I think we would want to take that one on notice.

Miss Ralph—Can we have a look at that, Senator?

Senator CONROY—I am happy for you to come back to us on that one. This one has a bit more publicity and I am surprised to see that you are willing to sign up to it. There has been a pretty significant change in the obligations of licensees to act competently and honestly, replacing the existing obligation, which is to act in an efficient, fair and honest way. What do you think of the effect of that change and of the requirement to only act so as to the extent that is reasonably practicable?

Miss Ralph—We understood and accepted that there might be a change in those sorts of words, which have been around for a long time, by and large because we are now suddenly applying this regime to a much wider range of products and services. A lot of those words—I

could be wrong in my history—would probably go back into the stockbroking days where effectively the licensee was an agent standing between two parties. The notion of having to deal fairly between two parties in a stockbroking environment is quite an important thing.

Senator CONROY—This is a consumer protection—

Miss Ralph—But less so in the instance where a fund manager is selling you a unit trust and selling you some units in a unit trust. We understood that concept of fairness might not be as applicable to the much wider range of products and services being caught by this bill and therefore you would look at those words that people have used for many years. Efficient? I do not think anyone really knew what 'efficient' meant. I am not even sure it was ever really tested. 'Efficient' was always a bit of a vexed word, in any case. 'Competent' is a word that we like and we certainly support. We think that was a good word to add to that. It actually means something. It can be tested and there can be benchmarks so people know where the levels are and those sorts of things. We understood why the words got changed and we were reasonably happy with the words that they got changed to. I have to say we are aware that some of the consumer groups see that change as a diminution in consumer protection. I guess we do not really read it as such.

Senator CONROY—To the extent that it is reasonably practical to do so?

Miss Ralph—We do not see—

Senator CONROY—Honesty and fairness, as long as it is reasonably practicable? Does that mean we can be dishonest if it is not reasonable or practical?

Miss Ralph—How we read that is: when would it be practicable or reasonable not to be honest?

Senator CONROY—So why qualify it? Why have it there?

Ms JULIE BISHOP—Because otherwise it would be a strict liability.

CHAIRMAN—As there are no further questions, I thank you very much for your attendance before the committee.

Proceedings suspended from 1.26 p.m. to 2.13 p.m.

JACKSON, Mr David John, Director, Australian Shareholders Association Ltd

ROFE, Mr Alfred Edward Fulton, CHAIRMAN, Australian Shareholders Association Ltd

CHAIRMAN—Welcome. Do you have anything to add to the capacity in which you are appearing?

Mr Rofe—David is also our representative on ASIC's Consumer Advisory Panel. He has been involved in some meetings with ASIC about the policy papers and things like that.

CHAIRMAN—We do not have a submission from the Shareholders Association so we look forward to your verbal presentation and then we will move to questions.

Mr Rofe—I will raise a couple of general issues and then a couple of specific points. Before I do, could I comment briefly on commission disclosure, because there has been a fair bit of discussion about that this morning. We support Lynn Ralph's comments. She has covered most of the issues. One question which was asked this morning was, 'Why don't some of these people's clients ask? Aren't they interested?' Certainly, if they came along to any of our meetings, they would realise that clients are interested. Probably one reason why they have not asked is that they do not realise that they are entitled to do so—and, of course, there is a certain amount of diffidence too. Do you want to add anything to that, David?

Mr Jackson—Quite often, you are dealing in many cases with very inexperienced people in terms of financial issues. Therefore, I believe it is beholden upon the legislation to give as much help to those individuals as possible. Therefore the issue of transparency is very important. To say that consumers do not ask questions is not the way to be looking at it. The question is: what question should they be asking and what answers should they be given if they are asking to invest, in some cases, their life savings in some of these projects that are being put forward?

Senator GIBSON—This morning, we were not discussing investment products. The discussion about commission disclosure was all around risk products and general insurance products.

Mr Jackson—And also life insurance products were mentioned, I think.

Senator GIBSON—No—general insurance. A rough example was if there is a $300 life insurance on a house or whatever from one company and a similar price from another company, the actual amount commissioned to the person selling the product was virtually irrelevant to the outcome for the customer.

This committee had recommended previously that the person doing the selling should make a disclosure that he is on commission but only disclose the quantum if the customer asked for it. The theme from the insurance people selling the things is that if they are forced to disclose the dollar amount up front, it will drive down commissions—which makes economic sense—and push all that work to the big players and badly hurt the smaller players who are selling such products. That was their thesis.

CHAIRMAN—You can only apply it to those social risk products—the fire insurance, house insurance, car insurance—and not to any product that has got an investment component.

Mr Rofe—I thought Lynn Ralph was talking about life insurance and I thought those three people before her were from the life insurance industry.

CHAIRMAN—I think they are broadly from the industry but the specific products they were talking about in terms of the disclosure issue were only the general insurance products—

Mr Rofe—I thought when they were talking about a commission of $2,500—

Senator GIBSON—On a life insurance policy, not an investment policy.

Mr Rofe—Okay. Firstly, I have a couple of general points. I am a little bit concerned at the complexity of what is essentially consumer protection legislation. Here we have a bill that is the size that the whole of the companies act was when I first started to practise law, and this is only half the story. You have got to look at the ASIC position papers. We have not seen the regulations yet and we have got the rules made by market operators and other people which are going to be given statutory force. When we talk about agreeing with the bill, we are only really talking about the tip of the iceberg.

Related to that is what I feel is an unduly short exposure period. In April last year, there were extensive consultations by Treasury with industry bodies and then the bill disappeared until it was introduced into parliament. It is clear from the points which people have raised today that it still needs finetuning. I think it would have been better if there had been a greater exposure period for people to go through it in more detail instead of trying to do it under what is a pretty tight timetable now to get it through parliament and in operation by 1 October.

One other point on the exposure period: I have a few brief words about the provisions relating to telephone monitoring during takeovers. Again, I think they have been rather sprung on the industry. I do not know that I have got very strong feelings one way or the other, but they do seem to be a sort of a knee-jerk political reaction to matters like the GIO class action. I do not know that there is any demonstrated need for provisions of this nature. The telephone calling that took place in the GIO case, and sometimes takes place, is only one aspect of communication with investors so I do not see a strong case to select out telephone monitoring during takeovers. There are other situations where telephone selling is very important, particularly in the case of managed investment products and, if you are going to have it for takeovers, perhaps you should have it there, or perhaps you should not have it at all as it is just an unnecessary imposition. Also, I know that some drafting issues about loopholes and so forth in relation to those provisions have been raised by other people, but I will not go into them now.

A general issue that I would like to raise in relation to the bill and the area that we are particularly interested in is whether there is a distinction between a financial product and an equity investment. With some of the products regulated by the bill—risk products like car insurance, house insurance and things like that—there is obviously no equity investment aspect. But when you are looking at shares, managed investment schemes, superannuation and investment life insurance products, you are really looking at an equity investment and, particularly in relation to superannuation, you are looking at a pretty long-term investment—it

might be a 40-year investment. To treat these products just as products, as distinct from investments, I think is a mistake. There is perhaps a range there. For example, in relation to managed investments, I do not think one would argue that cash management trusts needed the same sort of disclosure as, for example, equity trusts, property trusts or, in particular, managed investment schemes that involve carrying on some sort of business activity. I think the distinction between investing in a managed investment scheme and investing in shares is not great.

Some of the features we have been arguing for in relation to managed investment schemes are the holding of annual general meetings and the right of investors to participate in major decisions concerning their investments. This is also relevant in relation to the question of periodic accounts and continuous disclosure. It is not entirely clear to me, so far as periodic disclosure is concerned, as to whether a major change is anticipated by the act. Section 1017D talks about periodic statements for retail clients for financial products that have an investment component. We already have provisions in the Corporations Law dealing with annual accounts of managed investment schemes. We already have provisions in the superannuation industry legislation dealing with annual accounts for superannuation funds. It is not clear to me whether it is intended that section 1017D should supersede those provisions. If so, it would be a major backward step.

Also, I think there is confusion about the roles of various parties in relation to disclosure—not only periodic disclosure but also initial product disclosure. This is something about which David and I had some discussions with ASIC last week. It seems to me that there is a range of bodies potentially involved here: first of all, parliament, in relation to the act itself; Treasury, in relation to possible regulations; ASIC, which is issuing policy statements in practice notes; the Accounting Standards Board, potentially issuing accounting standards—and I note that they have got managed investment schemes and also superannuation on their agenda—and finally, industry bodies like IFSA, which have issued guidelines, for example, in relation to calculation of MERs. I think there is a problem here as to exactly who is doing what. One aspect of it which came up last week was in relation to initial product disclosure in relation to, on the one hand, managed investment products and, on the other hand, superannuation. There was a suggestion that ASIC will be issuing policy statements relating to managed investment schemes and Treasury will be preparing regulations in relation to superannuation.

Our position would be that with the convergence of products, which is one of the aspects behind the bill, that for many practical purposes investing in a managed investments product or a superannuation product, particularly a public offer product, is a very similar commercial decision. The main difference is that in superannuation you are tying your money up for a longer period. You have different tax consequences but essentially you are investing in a long-term equity product and we would argue that both the initial disclosure requirements—whether it is a product disclosure statement or whatever they call the superannuation one—should be similar. Similarly, the continuing disclosure requirements should be similar.

Mr Jackson—I would agree with that. The way that the statements are constructed should be such that they can be easily compared. It is no good having a 50-page document and each of the offerers having the information spread throughout the 50 pages. We believe the key information should be up the front and in a form that can be easily read and understood and compared by various consumers.

Mr Rofe—I know one issue which has been raised is whether either ASIC or the regulations might take an unduly prescriptive approach in relation to the PDS. We would say that this is a bit of a red herring because—as David says— in order that investors can compare products they really need the information in a similar format. They do not want to have one format from one company, another format from another company or a different format if it is a superannuation product. Going back a few years in relation to short form prospectuses for managed investment products, some research was done by, I think, IFSA in cooperation with ASIC, and it highlighted half a dozen or so particular features that typical investors were looking for about return and fees, et cetera. So we would support an approach which Lynn referred to as directed disclosure, and certainly we would support a uniformity of approach between managed investment products and superannuation and life insurance insofar as they were dealing with essentially similar products.

Mr Jackson—One example, which is in a different area, is the concise annual report which was introduced recently. Our members would say that it is really very hard to read. It is concise, but what does concise mean? In many cases those concise documents still run to 50 or 60 pages. To our way of thinking that is not a concise report. In hindsight, some form of structure should have been included with that so that it could have been reduced in size and key information could have been put in the right place. It is not serving the purpose that it was aimed to serve.

Mr Rofe—Yes, what is not included is probably just as important as what is included. David has given the example of the concise annual report. I think the same thing applies to a number of product brochures. The required information is there but it is so surrounded by marketing information, of pictures of girls jumping into swimming pools and things like that, that it is very difficult to find the key information that you require. Perhaps a requirement that there should be, say, a four-page summary up-front or a leaflet or something, separate from the distractions of the marketing information, could be worth considering.

I would like to make a few comments about the definition of retail clients. I am not sure that the bill really has involved a consideration of the reasons for distinguishing retail clients. For example, there are some areas in relation to continuing disclosure where it is said that this only applies to retail clients. I would think that whether you are a retail client or a wholesale client essentially you should be concerned about the same basic information about a product, and if you say that you do not need to provide this information for wholesale clients perhaps there is an implication that they are privy to other sources of information which are not available to retail clients.

Certainly I think I would agree that there is an argument for including what you might call the health warning on the cigarette packet. The financial services guide should be provided to retail clients because they are perhaps not familiar with the industry and the provider and so forth. But so far as basic financial information goes, I would suggest that there is really no need to distinguish between the retail client and the wholesale client. One of the important reasons for distinguishing the retail client is the difficulty they have in exercising their rights as investors. So I think there is an argument for having special dispute resolution provisions—special compensation requirements—for retail clients, but I think there are other areas in which the distinction between a retail client and a wholesale client is irrelevant.

I think the other point here is that, by adopting an unduly paternalistic approach to retail clients, one is in effect penalising them. Particularly in areas like the professional investor exemptions, it means that retail clients are prevented from investing in certain types of investment and prevented from investing in areas where there might be lower fees and commissions. So, as I say, they are in fact paying a penalty. Providing investors are fully informed and providing they are prepared to diversify their risks, I do not know that one should be too paternalistic. If you look at recent examples like HIH and One.Tel, some very wealthy and sophisticated investors have lost a lot more money than retail clients.

I would like to say something opposing the declared professional body exemption. I do not think that it serves any useful purpose. What, for example, is a 'professional body'? Is it accountants, lawyers, real estate agents, mortgage brokers, or what? Our argument would be that there should be a level playing field. If you are going to be a financial adviser you should have to be properly qualified and licensed, whether you also happen to be a lawyer, a chartered accountant or a brain surgeon. If you are going to be a financial adviser, you should be properly qualified and authorised, irrespective of what else you do.

Ms JULIE BISHOP—Or a journalist?

Mr Rofe— I think that past bad experience—Sorry?

Ms JULIE BISHOP—Or a journalist?

Mr Rofe—Yes. If you are going to give financial advice, I think that yes, you need to be licensed.

Mr RUDD—That is a very important definition question.

Mr Rofe—Of journalists?

Mr RUDD—In terms of whether they are purporting to provide financial advice or whether they are providing advice which might be construed by those who read it as being financial.

Mr Rofe—I think there is a problem there and also in relation to incidental advice. Just finalising the comment about declared professional bodies, I think the past bad experience with solicitors acting as mortgage brokers highlights the problems that can occur if you do not properly distinguish people's roles. I think this should also apply in relation to financial advisers.

I do not think that the provisions have been properly thought through. They talk about a professional body or a specified part of a professional body, but they then go on to purport to impose responsibility on the body and on its members, even though only part of the body has been declared. I suggest that they are likely to create more problems than they solve. Most representatives of professional bodies to whom I have spoken have said that it really will not be worth the effort to comply with the necessary requirements.

That leads me to the question of the lack of an exemption for incidental advice, which I think is a matter of concern. There is an exemption for lawyers giving advice about matters of law—legal interpretation, or the application of law—to any facts in section 766B. There is an

egal interpretation, or the application of law—to any facts in section 766B. There is an exemption from licensing for advice provided incidentally to the operation of a licensed market or a licensed CS facility in section 911A. There are also exemptions for other specified persons in section 911A and there is a definition in section 763E of an incidental financial product, which I suggest could be used as a precedent for a definition of incidental financial product advice. I know that even our association is concerned that, when we have meetings of our members at which they raise and discuss concerns about their investment and we talk about that, we are giving financial advice. We certainly tell people that we are not, but I would like to be supported by legislation in that view if I could.

That leads me to the clerk and cashiers exemption in section 766A, which I suggest is both too broad and too narrow. If the bank teller, in the course of serving a customer, advises that customer to invest in the bank's subsidiaries property trust because the trust is providing a higher tax-enhanced rate of return than the bank's interest bearing deposits, it could be argued that the teller is literally providing the advice of a financial service in their work as a teller. Conversely, a person working, say, in a call centre who is merely providing factual advice cannot really be said to be doing work of a kind ordinarily done by a clerk or cashier. I know that there has been pressure from the banks to provide some sort of exemption here. I do not think that the legislation has got it right.

The final thing to which I would like to say something about is dispute resolution and compensation. I think Senator Cooney raised this issue with Chris Conolly earlier today. Our experience has been that FICS has not been working well. We have complaints about delays and about a perceived bias because the scheme is financed by industry. We make the observation that, apart from needing a cheap, simple dispute resolution mechanism, people who seek to avail themselves of this mechanism really need assistance in preparing their claims. As I understand it, the body is located in Melbourne. People lodge claims in writing. They are then dealt with by a case officer who refers them to someone who makes the decision. If the complainant is not very skillful in expressing a complaint adequately, it does not get fully considered.

The second problem that we have observed is that there is no adequate mechanism for adequately testing the truth of the assertions which have been made. I can recall one recent situation in which a lady complained about certain advice she had been given. The adviser, who has since left the firm concerned, produced a note detailing the advice that he had given to her on a particular date. She sent in photostats of her diary, which showed that, on that date, she had been with her husband attending the doctor. There was no adequate mechanism to test the truth of those conflicting assertions. I guess that it is not a question for the bill, but it is certainly a question for the whole system, of which the bill forms part, that this dispute resolution mechanism needs further consideration.

The final thing to say something about is approval of compensation arrangements. I note that it states in the legislation that compensation is to be paid to retail clients of market participants in relation to property entrusted to those participants for the purpose of market transactions. What does that cover? It talks about property being entrusted to participants for the purpose of market transactions. What about property that is left there? What about securities held on a broker sponsored share sub-register; is that covered? Does it apply to cash management and other accounts which a number of particularly online brokers are requiring clients to open and

to which those brokers have access? On the face of it, such funds may not be entrusted to the market participant—in other words, the broker—and if they are left there they are not necessarily for the purpose of market transactions.

I guess what I am saying is that I think the bill needs some further finetuning. I think it would be unfortunate if it were pushed through without this finetuning being done, as happened in some other legislation, and then we would have to rely on ASIC to rewrite the laws to deal with the problems.

CHAIRMAN—Thank you, Mr Rofe. In relation to the issue of professional associations and the related issue of incident advice, you would see the licensing of professional associations as being adequate to cover the issue of incidental advice but not where the principal operation of the solicitor or accountant or whatever is financial advice?

Mr Rofe—That is right. The only professional association that I can think of that might possibly validly come within this exemption is the Financial Planning Association. My understanding from talking to Ken Breakspear is that they are not interested because they realise the impositions we would make on them.

Senator CONROY—That relates to a point which I think was made by Ms Bishop. We received a submission from Fairfax and News regarding the removal of the exemption on financial journalists from needing an investment adviser's licence. Do you have any knowledge of consumers suffering an unjustified loss because of the current exemption? Do you have a view on removing the journos?

Mr Rofe—Going back in the past I am certainly aware of problems which arose about journalists pushing particular securities in which they or their associates had an interest.

Senator CONROY—How long ago was that?

Ms JULIE BISHOP—Was it before there was a requirement for a register relating to financial interest?

Mr Rofe—Yes, that was the original reason for introducing that requirement for a register.

CHAIRMAN—Are you aware of how effective the register is? Is it kept up to date?

Mr Rofe—That I do not know. Another point that is relevant here is the blurring of the distinction between financial journalists who write in regular papers verses electronic newsletters and other means of communication. There is an increasing blurring of the line there. I suppose at one stage we had the normal newspapers, the financial journals, and we had Internet services. But now Fairfax, for example, has f2. I am sure it will be the trend that there is a complete blurring between paper communication and electronic communication.

Senator CONROY—To pick a recent example—the BHP-Billiton deal—a number of journalists did their own numbers. Trevor Sykes I think is one example. He did some calculations himself and said, 'I recommend that you do not vote for this deal.' Do you think that that falls within the scope of giving financial advice?

Mr Rofe—I guess, on the face of it, it does, doesn't it? On the face of it, it is making a recommendation in relation to a particular financial product. But, having said that, I think it would be a backward step if some of those well-known journalists, like Trevor Sykes and Brian Frith and so forth, were inhibited in what they do because I think they perform a valuable function in analysing a lot of the issues that are raised.

Senator CONROY—If they had not done their own calculations and they had just looked at the BHP calculations and said, 'No, we do not think that they are the correct valuations,' do you think that would be giving financial advice? I dropped off the 'I recommend, therefore, that you don't.' I am not sure whether they did. Is an analysis of someone else's calculations and recommendations financial advice in its own right? Where do you draw the line?

Mr Rofe—I think it is a very hard line to draw because you can effectively give advice without expressly giving advice, if you understand what I mean. It could be a person with a known reputation who would be making comments about a particular investment. Look at all those people who invested in One.Tel on strength of the backing that had.

Senator CONROY—Columnists are doing analyses. I refer to the money sections in the *Age* and *the Sydney Morning Herald*. I opened it out and there was, 'My three best tips to buy stock.' It was a genuine analysis piece, saying, 'This is where I think there has been a bit of undervaluing by the market.'

Mr Rofe—Yes. Unfortunately, though, even in that there is a range in the quality of information provided. Some journalists clearly have done a careful analysis and others probably just got a tip from their broker saying that such and such is a good thing. How do you distinguish between them?

Mr RUDD—Is it possible to craft some sort of multiple delineation between the advice available to the general public and the advice that is specifically provided to a prospective investor, resting on the central principle when the latter is specifically purchased? That is, when you buy a newspaper I presume it is a difficult and possibly tendentious argument that you are buying that newspaper as a source of rolling financial advice in terms of what you do with your personal investments of one description or another.

It is more sustainable perhaps—and this is purely for the purposes of discussion here—that, when you are purchasing a financial newsletter from someone who classically falls within the definition contained in the proposed act as the provider of financial product advice, once you have actually committed to the purchasing of the contract, presumably at that point questions about professional indemnity insurance also kick in. I do not know but I am saying that, once you have an exchange going, presumably the advice falls into a different category as opposed to that which is more generally broadcast. Is that a robust delineation or not?

Mr Rofe—I do not know that there is a clear-cut distinction there. Certainly the bill seeks to distinguish between general advice and personal advice.

Senator CONROY—So if I subscribe to the *Financial Review* I am in a contract but if I just buy it daily it would not be general advice?

Mr Rofe—I do not know that you can draw a distinction like that. I subscribe to the *Australian Financial Review* Monday to Friday, but I go down to the newsagent to buy the weekend one because it is my exercise for the week. To some extent I get the *Financial Review* because of the financial information provided there, but I probably get a better and more in-depth analysis from Brian Frith of the *Australian* or from Trevor Sykes.

Senator CONROY—Perhaps you could set up a deal and say, 'Deliver the *Australian* but not the business section.

Mr Rofe—I do not know whether you can do that. There would be practical problems, in particular because of the convergence of different media sources nowadays. I do not think that there is a simple answer. I guess that is because of the increasing influence that the media is having, and it is not only the print media but a number of television programs.

Senator CONROY—David Koch and Paul Clitheroe?

Mr Rofe—That is right. The answer might be to require some form of licensing there.

Senator CONROY—The bill will amend the market offence provisions. Do you have any concerns about several of the market offence provisions, including the continuous disclosure regime and the insider trading provisions, becoming civil penalty provisions?

Mr Rofe—I must admit that I have not looked at those sufficiently closely to be able to give a useful answer. One of the key arguments is that insofar as having civil penalty provisions rather than criminal provisions it may make the onus of proof easier to satisfy. To that extent it may result in more effective enforcement of those provisions.

Senator CONROY—You probably heard me asking questions of Ms Ralph earlier. In terms of that insider trading provision, the wording of that provision will go from what the insider 'ought reasonably to know' to 'is reckless' if the information is not generally available. Do you think that will affect ASIC's power to enforce? I am happy for you to take that on notice.

Mr Rofe—Do you have the section reference handy?

Senator CONROY—I am sure we can get it to you.

Mr Rofe—I will have another look at that. I certainly think that the continuous disclosure provisions are very important. There is an argument that in some cases they have not been followed up as well as they might have been. I think there is more consciousness of that now and it is important that they continue to apply to managed investment products and generally to long-term investment products.

CHAIRMAN—Thank you for appearing before the committee.

[2.54 p.m.]

AMOS, Mr Roy Frederick, Director, Australian Surety Association

IRONFIELD, Mr Murray Edward, Alternate Director, Australian Surety Association

ROBINSON, Mrs Marianne, Legal Adviser, Australian Surety Association

CHAIRMAN—I welcome representatives from the Australian Surety Association. We have before us your submission which has been numbered submission No. 9. Are there any amendments or corrections that you require to make to that submission?

Mr Amos—I would like to open with an address which is intended to expand and refine some of the comments made in the submission.

CHAIRMAN—But there are no amendments to your submission. In that case, I invite you to make some opening remarks. At the conclusion of those remarks we may ask some questions.

Mr Amos—Thank you for giving us an opportunity today to represent the Australian Surety Association, which I will refer to as the ASA. The ASA is an industry association that was formed in early 1999 to represent the interests of organisations issuing surety bonds in Australia. In 2000 the ASA was admitted as a member of the International Surety Association.

The emergence of the surety bond market within Australia has been relatively recent, with most growth occurring in the 1990s. We are aware that, while our product is used in many ways, in particular, for large construction and infrastructure projects, there is little public awareness of surety bonds or how they operate. Since the introduction of surety bonds into Australia the business has grown to the point where, on the basis of our best estimate, the annual aggregate face value of surety bonds issued is in the vicinity of $1 billion. Consequently, members feel that surety bonds are making a valuable contribution to the economy.

We are here today because our members are seeking a short amendment to the Financial Services Reform Bill. The ASA has made two submissions to Treasury and one to ASIC requesting clarification of the status of surety bonds once the Financial Services Reform Bill is passed. We have received no response other than an acknowledgement of the submissions. So now, on behalf of our members, we are asking that the relevant part of the FSR Bill clarify the status of surety bonds by explicitly excluding them from the reforms.

The written submission that you referred to, Mr Chairman, which has been lodged with the committee, was prepared in a limited time period. After consultation with our members we have been asked to clarify some of the aspects of that submission. Respectfully, the ASA holds the view that, first, surety bonds are not a financial product within the definition in the FSR Bill. Second, surety bonds fall outside the definition of a product for which a person 'manages financial risk'. Third, the definition of a 'risk product' covered by the FSR Bill is not sufficiently clear. Four, there will be considerable imposts on ASA members and the authorities if the position of surety bonds is not clarified within the scope of the FSR Bill.

To explain the concerns of our members, it is probably necessary, first, to describe how a surety bond operates. Generally, surety bonds are used to support commercial and construction transactions. Examples of projects involving surety bonds in Australia in recent years include the building of public roads and tollways, power stations, hospitals, prisons, sewage treatment plants and waste disposal, retirement villages and general residential and commercial developments. While there are variations in the types of bonds, their terms and even the nature of the obligations they support, there are core elements shared by all surety bonds.

Essentially, a surety bond is a promise or an undertaking made by the surety bond provider to meet its customer's contractual obligations to a third party. For ease of reference I will call the surety bond provider the surety. This promise may take the form of paying a sum of money or performing some specified obligations of the customer should the customer fail to meet those obligations. The surety bond does not in any way vary, add to or remove those obligations.

The surety issues the surety bond on the basis that its customer gives the surety a legal right to be fully reimbursed by the customer in respect of all payments made and any losses, expenses or other liabilities incurred by the surety under the bond. That means that if, as a result of the default of its customer under the underlying contract the surety makes a payment or incurs liability under the bond, the surety will be entitled to be fully reimbursed by its customer in respect of that payment or liability. Similarly, the ultimate responsibility for the payment or performance of the obligation remains at all times with the customer.

There are three key relationships between the parties: first, the underlying contract creating obligations between the customer and the third party, for example, a construction contract; second, the relationship between the surety and its customer; and, third, the bond issued by the surety in favour of the third party.

Unlike most financial services products, surety bonds are not sold to the customer in the traditional sense. What gives rise to the need for a surety bond is the requirement imposed on the customer by the third party under the terms of the contract between the customer and the third party. The customer approaches the surety to provide the surety bond to enable the customer to meet its contractual obligations to that third party. The surety's customer may request that the surety provide factual information to the third party. There is no 'financial service' as defined within the terms of the bill provided by the surety to the third party and the third party does not pay any fee to the surety.

By contrast, general insurance products involve a transfer of risk from the insured to the insurer. That is, in consideration of the payment of an insurance premium the insurer assumes a risk that would otherwise be retained by the insured. Importantly, there is no risk transfer involved with surety bonds, that is, there is no risk transfer from the customer to the surety. Again, the ultimate risk in relation to the payment or performance obligations under the underlying contracts remains at all times with the customer. If the customers fail to perform those obligations the surety will either pay a sum of money or perform those obligations. The surety will then seek reimbursement from the customer.

Another way of saying that is that, at the end of the day, the customer is in the same position, in relation to its exposure to the consequences of its failure to meet its contractual obligations,

as it would have been without the surety and the surety bond and if it had been exposed solely to the third party. The surety bond does not vary the risks faced by the customer.

The position outlined by us today in relation to surety bonds is supported by specific rulings that the ASA and individual surety companies have obtained on the status of surety bonds from APRA and the ATO. APRA and its predecessor, the ISC, have ruled on not less than half a dozen occasions in response to submissions made by the surety companies that surety bonds are not contracts of insurance. The ATO has also issued a private ruling in favour of the ASA and its members, stating that surety bonds are not contracts of insurance because they do not involve any transfer of risk.

In our view, it is clear that surety bonds are not a financial product within the definitions in the FSR Bill of 'financial investment' or 'a non-cash payment.' The third category deemed to be a financial product for the purposes of the bill is a facility through which a person manages the financial consequences to him or her of a financial risk. The ASA believes that the status of what constitutes a 'financial risk product' covered by the bill is not sufficiently explicit for the purposes of surety bonds which will mean that ASA members will be required to approach ASIC on a one-to-one basis to seek a ruling on the status of surety bonds.

Simply, the ASA submits that surety bonds fall outside the definition of a product by which a person 'manages financial risk.' This is because the concept of a risk product encompasses arrangements where financial risk exposure is 'transferred, hedged, adjusted, or where cash flow or price certainty is provided.' Surety bonds do not share any of these characteristics. In the relationship between the surety and its customer there is no transfer or other adjustment of the risk position. The ultimate risk position resides at all times with the customer.

The ASA has been a proactive association in explaining to regulators the mechanics of the surety bond relationships and it has been successful in demonstrating why the surety bond falls outside the parameter of a risk transfer product. While ASA members have been successful in all cases where they have sought rulings from APRA and the ATO, the fact is that they have had to do so. Experience with APRA and the ATO has taught ASA members that obtaining private rulings can take some time, especially if the product falls outside the usual parameters.

The ASA sees this as an opportunity to save both its members and ASIC the time, additional workload and cost involved in preparing individual case submissions and reviewing and responding to the submissions to clarify a position which has been investigated and previously determined by APRA and the ATO. That position is that surety bonds do not involve risk transfer and so are not a facility or arrangement by which the customer manages the financial consequences of risk to themselves. To ensure that consistency is maintained we seek a clear statement in the FSR Bill that surety bonds are excluded.

We appreciate the volumes of work that will eventuate on the enactment of the bill in seeking individual rulings from ASIC. As surety bonds are not a well-understood product, the potential is that any submission seeking individual rulings by our members will be delayed by this lack of understanding. This would only frustrate and distract the business sector in its efforts to provide a competitive solution to market. Given the previous investigation and subsequent outcomes, we seek the committee's support in excluding surety bonds.

The intention behind the FSR Bill has been stated as being one that is sufficiently flexible to cater for the development of new products into the future. The ASA, on behalf of its members, is simply seeking a clear statement in the FSR Bill on the status of an existing product. That would be achieved, we submit, simply by the addition of the words 'surety bonds' in section 765A(1) of the bill. For the purposes of the definition section in the bill it is submitted that the following definition could be appropriate:

'Surety Bond' means an agreement or undertaking given by a company (Surety) at the request of its customer, in connection with its customer's contractual obligations to a third party, to pay an agreed sum to, or perform a specified obligation in favour of, the third party in the circumstances where, if the Surety makes the payment or performs the obligation, the Surety is entitled to be fully reimbursed by its customer in respect of any payment made or liability incurred under that agreement or undertaking.

The FSR Bill was drafted to extend certain financial products. The ASA is simply submitting that the products of its members do not fall within the definitions of the bill. Given the past experiences with regulators, ASA members simply ask that this should be recognised finally within the exclusions in the bill. I conclude by saying on behalf of ASA members that I appreciate the opportunity to address the committee today and to put forward the case for our members.

CHAIRMAN—Do either of your colleagues wish to add to that statement?

Mr Amos—No.

Senator GIBSON—I cannot imagine that there was ever an intention to cover surety bonds. Have you had advice from lawyers that that may be the case?

Mrs Robinson—The difficulty is—and I think this is part of the submission—that they have had to deal with this on every single instance with every single regulator in the past.

Senator GIBSON—I understand that in relation to APRA, yes.

Mrs Robinson—And the same applies to the ATO in relation to the GST. Our advice to the Surety Association is that it will continue to have this difficulty because of the lack of understanding in relation to surety bonds. So it is preferable to just have the exemption up-front, especially given that ASIC would require to have a look at it on a one-to-one basis.

Senator GIBSON—It seems to me that we would need to take advice ourselves in relation to that interpretation of the law.

Mrs Robinson—Precisely.

Senator GIBSON—I am sure about the intention of surety bonds, which I understand because I have been involved with the construction industry in the past. Most people would not have much contact with them. But I am sure it was not the intention that they be covered. So I think your request is fair and reasonable, but whether it is necessary is something we will have to investigate.

Mrs Robinson—The difficulty is that the question of risk is not defined. In the draft bill there were fewer noted exceptions. The list of exceptions has now become longer and the bill basically starts with the philosophical statement that unless you are exempted you are in. So we are trying to anticipate that by saying that we would rather it be stated as being out, rather than having to go through ASIC and having that clarified.

Senator GIBSON—I understand that. Have you made an approach to the government or to the minister concerned?

Mrs Robinson—We have gone through the official channels in all our submissions. As I have said, this is the first time that the association has actually had anyone who has listened to its submission.

Senator GIBSON—Have you written to the minister?

Mrs Robinson—Not to the minister direct, but certainly we made submissions that followed the draft bill. There were two submissions after the draft bill and another one to ASIC as well.

Senator GIBSON—In the process of reviewing the bill?

Mrs Robinson—Yes.

Senator GIBSON—And you did not get a response to them?

Mrs Robinson—No.

Senator CONROY—What licensing requirements currently apply? Do you have any regulations that outline those requirements?

Mrs Robinson—It is regarded as a normal commercial transaction.

Senator MURRAY—In your submission you mentioned transitional arrangements, but I did not pick up the period that you wanted transitional arrangements to apply for.

Mrs Robinson—We are actually asking that we be excluded specifically.

Senator MURRAY—But what if you were not excluded?

Mrs Robinson—The concern was that, up until the release of the consequential amendments bill last week, because surety bonds are not regulated now they would not have qualified for transitioning at all, which means that the industry would not have the ability to issue surety bonds at all from the day of the commencement of the bill, bearing in mind that they would have to apply full licensing applications immediately.

CHAIRMAN—Thank you for your appearance before the committee.

[3.12 p.m.]

GILLIGAN, Ms Patricia, Senior Legal Counsel, Sydney Futures Exchange Corporation Ltd

STARR, Mr Malcolm, General Counsel, Sydney Futures Exchange Corporation Ltd

CHAIRMAN—Welcome. We have not received a written submission from you. Therefore, I ask you to address the committee. At the conclusion of that address we might wish to ask you some questions.

Mr Starr—We have, in fact, made numerous submissions to Treasury over the years on this subject. Our most recent one I think was provided to the committee some time ago. I am happy to summarise our main issues and views on the bill. We recognise that, for some financial service providers, the bill will involve a very different regulatory regime from the one they are currently used to. This is not so much the case for a group like SFE, which operates a couple of exchanges—the Sydney Futures Exchange, by which we were known until recently, and one in New Zealand—and a couple of clearing and settlement facilities—the SFE Clearing Corporation, which until recently was known as Sydney Futures Exchange Clearing House, and Austraclear.

What is being proposed for such a group is essentially the existing regime with some new names for licensed categories and some slightly different regulatory hurdles to be surmounted if an exchange or a clearing and settlement facility wanted to broaden its product range. Of course, there is also the useful tidying up of distinctions between securities and futures. That, in itself, is something that should be achieved as soon as possible and it is one of the reasons why we support getting the legislation in place as soon as possible. Whilst headline changes to a number of licence categories and new disclosure obligations are likely to be significant for many service providers, the changes for market operators and clearing facilities are rather more subtle.

We have some difficulty identifying tangible benefits for users of our markets and clearing facilities from these subtle shifts. But for our part we do not have strong objections to the finetuning of the existing regulatory relationships that the bill would involve. I would like to highlight three of those subtle shifts. First, contrary to widely held assumptions about the purpose or effect of this draft legislation, it does not simply enable market operators to compete with one another. Instead, it simply empowers the minister to set rules as to when competition will be permitted. Second, this legislation accelerates the ongoing shift away from exchanges being seen as autonomous self-regulators and more towards being seen instead as simply another category of regulated licensee.

Third, whether the new regime relating to regulation of clearing and settlement facilities will be significantly different from the existing regime is not capable of being fully answered from reading this legislation. Major threshold decisions on issues such as who will be the regulator or regulators and which clearing and settlement businesses need to be regulated have still not been fully spelt out. I would like to elaborate on those three themes.

Let me start with the point about the legislation not directly ushering in greater competition but giving the minister scope to set some rules about competition. Here are some examples. The

legislation does not permit SFE or anyone else for that matter to set up an equities market in competition with, say, the ASX any more than they can do under the existing legislation. The draft legislation simply spells out some of the things which the minister would need to consider when varying an existing licence rather than granting a new one or, more accurately, when varying the grandfathered licence that we presumably will obtain. For example, the minister will now be explicitly required to consider whether the potential new entrant had established a new compensation fund specifically for retail users of the new equities product. Similarly, the legislation does not permit an organisation like SFE to be involved in transferring title to securities. All it does is empower the minister to select from amongst the facilities that have been given a licence those ones that will be authorised by regulation to transfer title. According to the explanatory memorandum, this would occur only after the proposed structure has been vetted and issues such as stamp duty had been considered by the minister.

Our second observation about the legislation is that it embodies a subtle shift away from exchanges being seen as autonomous self-regulators and towards being seen instead as simply another category of regulated licensee. We do not have any fundamental difficulties with this shift. The legislation retains requirements that market operators supervise the conduct of their customers as it also regulates many of those customers directly. It licenses them as financial service providers. The effectiveness of any such arrangements is, therefore, heavily dependent on any understanding reached between ASIC and a market operator as to their respective roles in regulating the conduct of users of the markets that we provide.

In practice, market operators tend to take the lead in monitoring whether market participants are complying with their obligations as they relate to futures and options trading, whether those obligations arise from the Corporations Law or from our own market rules. ASIC has been notified of any disciplinary action which the market operator takes and if in addition to a breach of our rules there was a breach of the law, ASIC may take additional enforcement action. ASIC also has an involvement in reviewing any changes which a market operator makes to its product line-up, or to its disciplinary arrangements. The draft legislation does not fundamentally alter this structure. It is likely, however, that ASIC will more clearly be seen as the regulator of market operators and not merely as the overseer of how we, in turn, regulate our users.

This is evident from new features such as legislative mandating of the existing practices of exchanges providing an annual report to ASIC as to how we have complied with our obligations; ASIC having responsibility in turn to produce an annual report to the minister on compliance by market operators with their obligations; and the minister's capacity, in relation to smaller market operators, to delegate his or her powers to ASIC, including powers to disallow rule changes, give directions, et cetera. We struggle to find examples in these changes of things that will make a significant difference to users of SFE's markets.

Nevertheless, we recognise that new entrants into the market operator business are not likely to be seen instantly as credible autonomous regulators. Accordingly, the legislative regime needs to evidence a well-stocked arsenal of big sticks that could be used equally against us as against a new fledgling market operator. It is a moot point whether all these changes add up to a significant shift in the day-to-day relationship between ASIC and market operators. We tend to see the proposed changes as simply another step in the inexorable trend away from market operators being seen as autonomous regulators. They will now clearly be licensees subject to being regulated themselves. The reality is that any regulation of our customers that we

voluntarily undertake, even if it does constitute the majority of the regulation that those customers experience, is additional to the regulation of us and our customers that ASIC chooses to undertake, or requires us to undertake.

Finally, I comment on regulation clearing and settlement facilities. The minister has foreshadowed further amendments relating to regulation of clearing and settlement facilities. We understand this to involve decisions about the extent to which the Reserve Bank and ASIC should each have a role. SFE already has several points of interaction with both regulators and would be content with any outcome that avoids duplication. This is a particularly difficult issue because, notwithstanding the impression created by the draft legislation, clearing and settlement involves fundamentally different risks being addressed to those which are the subject of the market operator and financial service provider regulation. In deciding which regulator is to be accorded which functions, the government needs to recognise that the central focus of effective clearing and settlement regulation will inevitably be on the prospects of default by users of the clearing and settlement facility. In other words, default by the banks and other financial institutions which could default on their obligations to the clearing facility if, for example, their clients in turn defaulted on their obligations to the clearing participant—the bank.

Therefore, it is vitally important that whatever allocation of responsibilities the government chooses it does not involve two regulatory agencies simultaneously attempting to assess the prospects of default by a clearing participant—one of our customers. We have indicated to the government that if it were inclined to split regulatory responsibilities between, say, the Reserve Bank and ASIC, and while ASIC might logically be the regulator with respect to market conduct and integrity issues, it would not be so obvious that ASIC should deal with systemic concerns. It would, we suggest, be appropriate in that event for ASIC to effectively subcontract exclusively to the RBA any assessment of structural arrangements that need to be undertaken in order to provide that assurance that systemic risks have been adequately addressed.

In summary, there are still some uncertainties to be resolved. However, this bill has already benefited enormously from changes that the government has been prepared to take on board in response to submissions from SFE and others. As we get closer to implementation it become more difficult for someone in market operator and clearing businesses to implement major initiatives without knowing whether the scheduled commencement dates for legislation of this type will be achieved. Accordingly, we look forward to this uncertainty being removed by the early passage of legislation broadly in line with the current proposals.

CHAIRMAN—Ms Gilligan, do you have anything to add?

Ms Gilligan—Not at the moment, no.

Senator MURRAY—It is plain that you want the legislation to go through. It is plain that you fear cost of compliance and uncertainty arising from conflicting regulatory activity. To an extent that is axiomatic. There are slices of ASIC, for instance, which cross with APRA and the ACCC, and that will continue to be so. As I understand it, the way they resolve that is to prioritise through a memorandum of understanding who has the main hits in certain situations. I see no conflict in, say, to give you an example, a bank being kissed by APRA for good prudential regulations and being kicked by ASIC for poor consumer provisions or perhaps being kicked by the ACCC for some fee transaction at the same time.

What you are referring to, I presume, is when the same issue is being dealt with differently by two different regulators. I wondered whether you had more precise solutions as to potential conflicts in your industry than you outlined in your discussion? Where could this happen, and how could we suggest ways of stopping it from happening?

Mr Starr—I made the comments quite deliberately because we strongly support your opening remarks about there being no difficulty with APRA looking, for example, at functions associated with depositor protection, a raft of regulatory objectives, ASIC at market integrity and consumer protection, and RBA at systemic risk—all the usual catchcries that came out of the Wallis committee inquiry. We strongly support that approach, which we recognise involves the same institution being regulated in respect of different aspects from different perspectives.

What we are drawing attention to in relation to this issue is that when you set aside the exchange issue and focus exclusively on clearing houses there is, in a sense, only one issue to be looked at. That, I believe, is the departure from the APRA versus ASIC model that we started talking about. If one is looking to achieve the outcome that there will never be tremendously serious systemic consequences from a collapse of a clearing house which in turn means that it cannot honour its obligations to its clearing participant members, that is going to come around either from the clearing house making a monumental mistake in its operational procedures or, more likely, from a default from one of its clearing participants.

Senator MURRAY—Let me test you as we go along so I can follow this. It seems to me already that there is a dissonance in what you are saying. One way in which collapse and default might occur is just really bad corporate governance issues—for instance, directors who are too close to auditors, and auditors who do not do a proper job. You can recognise the scenario. That, to me, is very much the concern of ASIC and it is very much the concern of APRA—ASIC because of its interest in the professional independence and the way in which directors, auditors and boards are structured, and APRA from the point of view of how it affects a major financial instrument, if you want to describe it in that way. But the dissonance I refer to is that I think you were saying that if there were technical, market or operational reasons for the default, that should be subject to just one party examining it.

Mr Starr—I think that is a good summary of my proposition.

Senator MURRAY—Which I assume would be similar to capital adequacy ratios or those kinds of technical assessments at risk. Who do you think should do that side of it?

Mr Starr—We are saying that we think that function—and I use the expression subcontract—could conveniently be performed by the RBA because it is unequivocally the regulator of systemic risk issues. ASIC is unequivocally the regulator of some of those issues that you characterised as corporate governance issues—whether the directors had got too close to the auditors, et cetera. What we are essentially saying is, 'Okay, once we have got past ASIC focusing on those corporate governance issues, what in relation to something integral to the nature inherent in the nature of a clearing business would it get to look at?'

Would it look, for example, in the same way as it looks at a broker to establish whether or not the broker had adequate systems in place? We are saying that the instant that you start having ASIC asserting a right to jurisdiction because it is somehow connected with those corporate

governance issues—or is somehow similar to the way it regulated a broker in order to give consumer protection to the clients of a broker—you run a real risk that each regulator will be saying, 'I am looking at the prospect of a default by a clearing participant from the systemic risk perspective,' and ASIC says 'I am looking at the prospect of a clearing participant default from a corporate governance perspective,' and you find the real duplication starting. I am saying that, in the area of looking at clearing houses, there is not much to do other than look at the prospect of default by a clearing participant.

Senator MURRAY—In summary, you are saying that the technical ability and the competence to do that job properly resides with the RBA. I assume also from what you are saying that there is no clarity in the legislation at present as to who has that specific function with regard to your industry. I presume, therefore, that what you are asking the committee to do is to make some recommendation as to where that responsibility should lie.

Senator GIBSON—You are recommending to us that ASIC should be the single regulator and subcontract out the settlement supervision of a systemic nature back to ASIC, so that in fact regulations—

Senator MURRAY—Back to the RBA.

Mr Starr—Back to the RBA. Let me clarify, first, the comment about the suggestion that we are asserting that the RBA has greater expertise. That is no part of our proposition and we do not wish to be involved in selecting the regulator. Our formulation is unequivocally: pick a regulator and make sure that there is not duplication. The second proposition is: this committee is going to be faced with reviewing the amendments that the minister has foreshadowed to this legislation when he introduced it and said, in respect of the clearing and settlement facility area, 'I am planning to introduce some further changes after consultation.' I am suggesting to the committee that it is an issue that the committee will need to address in order to produce its final assessment.

Senator MURRAY—My colleagues will be able to advise me, but I think a ministerial direction statement could do that. Just say to the RBA, 'You will pick up this particular area.' I will make the statement as you will not, but I think those kinds of areas you are discussing now—not the general corporate governance areas—are areas which ASIC indeed has the competence to handle.

Mr Starr—Indeed it does.

Senator MURRAY—In areas of international relationships and experience and understanding only the RBA has that technical ability. I do not see any problems with what you are suggesting.

Senator GIBSON—The choice really is, to follow your central recommendation of just one regulator, that either ASIC is the lead regulator and has work done by RBA, or the reverse applies. Presumably this issue will be covered in regulation.

Mr Starr—That is right. The issue that I am drawing to your attention is that there is great scope for it appearing as though the legislation has fixed the problem when it has not. That is

the issue that needs to be looked at. The one great risk is, for example, to simply use words like 'systemic risk' and say, 'Well, the RBA has to look at this activity from a systemic risk perspective and ASIC has to look at it from a market integrity perspective,' and that would not be a satisfactory delineation. I am saying that one has to go one degree further, to a subcontracting model, and we do not care which way it goes.

Senator GIBSON—You do not mind which way it goes, as long as it is clearly defined?

Mr Starr—Yes.

Ms JULIE BISHOP—You mentioned earlier the distinction between securities and futures being dealt with in the sense that there will be a single licensing regime for financial markets. You are not satisfied that that, therefore, covers any existing inconsistencies, difficulties and complexities that currently exist under Corporations Law?

Mr Starr—Yes, we are satisfied with the outcome. We had to arrive at some necessary compromises in order to reflect the fact that we have prospectus requirements for securities and we have one of these new disclosure obligations for certain other products. Therefore, the securities futures distinction is not being permanently eliminated by this legislation. But we do not have any problems with the solutions that have been adopted.

Ms JULIE BISHOP—When you said earlier one of the nuances or one of the subtle shifts was the empowerment of the minister to set rules as to when competition exists, were you talking about competition in relation to clearing and settlement facilities, or were you talking about competition per se?

Mr Starr—Per se, across the board. Let me give you an example. I gave an example in my opening remarks. Say we wanted to embark on a completely new area. Say that you have a licence to conduct a derivatives exchange, or you have a financial service market operators licence that enables you to trade the products that you currently trade and are grandfathered in respect of those. But if you wanted to move into a product then this legislation states that you have to go back to the minister and satisfy him that you have the expertise to go into the new product. My point is simply that there is not much difference between going back and getting another licence versus going back and amending your existing one. You are going through the same issues. We do not criticise that. We simply make the point that nothing particularly dramatic is changing here.

Let us take the example a bit further. Say SFE Corporation is essentially servicing the wholesale market, but we do have some retail involvement. Let us say we went in to a new product which we are not currently offering and which was much more focused on the retail end: we would need to satisfy the minister that, for example, our fidelity fund arrangements were adequate to cater for whatever number of retail participants might be anticipated to come in to this product. So you can see that perhaps we are going to have to come back with an actuarial analysis of what, compared with our existing claims history, you would expect the claims history to be, in order to justify the ministerial approval of the amount of funding necessary to go into the new fund. We see us still facing those sorts of issues. That is perfectly appropriate; we have no criticism; but I think it is worth pointing out that that is what we are talking about.

Ms JULIE BISHOP—Finally, obviously the regime is also intended to lower or remove the barriers to entry of overseas facilities. Do you see any issues there that we ought to be aware of, in terms of the participation of overseas markets and facilities?

Mr Starr—I think the legislative provisions are broadly correct. We have to have an arrangement that allows overseas market operators to be allowed to come and compete with the existing operators, without having to face the duplicative regulation that I have just been expressing concerns about. If those operators are regulated in respect of in their home market, it would be unduly restrictive of Australia to try and assert that ASIC must be allowed to tick every box again, but within that realm you have obviously got some pretty hard judgments to make. Are we talking about a market operator that was approved in respect of the existing products when ASIC got it approval—and then, when it raises a completely new product, does it have to get the box ticked by ASIC or not? There are some hard issues in there that ASIC will have to face, but in terms of the structure—of the way the legislative provision is set up—we do not have any problems.

Ms JULIE BISHOP—Thank you.

CHAIRMAN—Thank you, Mr Starr and Ms Gilligan, for appearing before the committee.

[3.39 p.m.]

HRISTODOULIDIS, Mr Con, Senior Manager Public Policy, Financial Planning Association of Australia Ltd

CHAIRMAN—Welcome. We have before us submission 17, of the Financial Planning Association. Are there amendments that you wish to make to the submission?

Mr Hristodoulidis—No.

CHAIRMAN—Do you wish to make an opening statement?

Mr Hristodoulidis—Yes.

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

Mr Hristodoulidis—My opening statement will, like those of previous participants, also expand on what was contained in the submission, so I will work through that. The Financial Planning Association of Australia, which I will refer to from here on as the FPA, is the peak professional organisation for the financial planning industry in Australia. We have over 12,000 members through a network of 31 chapters across Australia and a state office in each capital city. The FPA is the only organisation that fully represents qualified financial planners and their principal licensed dealers. Our members advise on and/or manage the financial affairs of approximately five million Australians with an investment value of about $156 billion. The FPA has been extensively involved with, and a supporter of, the Financial Services Reform Bill process previously known as CLERP 6. The FPA was one of the first associations to recommend the introduction of the uniform regulation of all financial products and a single licensing regime for financial services providers. We also proposed, and welcome, the universal standards of conduct and uniform disclosure obligations for all those financial services providers dealing with retail clients.

Such a regulatory regime, we believe, promotes competitive neutrality, clear operating standards and accountability for conduct and consistent and comparable financial product information. In turn, we believe this promotes a high level of informed decision making by retail clients. The FPA appreciates the exhaustive consultation processes followed by the government on the draft exposure bill that was introduced in February 2000. More importantly, as stated in our submission to the committee in April 2001, we welcome the improvements made to the current bill from the draft exposure with respect to the tightening of the provisions surrounding declared professional bodies and the inclusion to formally recognise that a licensee can have a direct contractual relationship with the corporate representative.

If I can just sidetrack myself there for a moment, I would like to clarify some comments made by Mr Ralph with respect to our CEO, Ken Breakspear, on the issue of declared professional bodies. The FPA has always opposed ‘declared professional bodies’, and has always wholeheartedly supported a single licensing regime. The issue of not proceeding down a ‘declared professional body’ route is not the fact of the complexities of the provisions; rather,

we think that a single licensing regime adds more value from a consumer protection perspective.

The comments that follow with respect to certain sections of the legislation are based on new measures introduced into the bill since the draft exposure, and on what we perceive to be unintended consequences that do not satisfy the objectives of the bill of consumer protection and facilitation of greater activity in the financial services sector. The three areas I would like to focus on include fee and commission disclosure, subauthorisation and minimum training and competency standards of financial advisers.

Firstly, the FPA is pleased with the requirement of full disclosure of all fees, commissions, bonuses and any other interests by all financial service providers in the statement of advice. However, we remain concerned that, at the product disclosure level, commission paid on risk products is not required to be disclosed, whereas disclosure on investment products does. Apart from compromising the level playing field for all financial service providers, it also reduces the level of consumer protection. The FPA, in particular, is concerned that this interpretation of commission does not open up a loophole whereby risk product commissions are loaded up to avoid disclosure to consumers and artificially raise the returns of the attached investment product.

Secondly, as stated earlier, the FPA welcomes the changes in the current version of the bill to allow for subauthorisation and supports the government's intent, as expressed in the explanatory memorandum, that this new approach will provide authorised representatives with greater flexibility and will accommodate existing representative structures. This is an improvement, but unfortunately the choice of wording in the new section 916B of the bill raises the possibility of unintended consequences. Under section 94 of the current Corporations Law, the licensee and the proper authority representative may service the investing public under an arrangement between them or one that involves a third party. In contrast, the FSR Bill refers to an authorised representative providing financial services on behalf of the licensee. Such an approach fails to recognise the separate and independent value that the financial planner brings to the dealer relationship in the servicing of the investing public's needs. Further, making people responsible for their actions cannot be the justification for the 'act on behalf of' argument, as section 917A onwards of the bill quite clearly outlines the liability of both the licensee and their representatives.

Before moving on to the third point, I would like to take a few moments to indulge myself in my favourite topic, which you are probably all aware of, and that is the alienation of personal services income. I would like to say that the 'act on behalf of' also has a detrimental impact on the industry with the application and a narrow interpretation of the alienation of personal services income law by the ATO. More specifically, the ATO have argued, and will continue to argue, that recurring income on investment products represents personal services income at the point of payment. However, it also seems as though the ATO want a second bite of the cherry, as they argue that the sale of the client list by a financial planner incurs a capital gain, and therefore the planner is liable to pay capital gains tax. The FPA supports the Association of Financial Advisers' comments from earlier today that reoccurring income from both investment and risk products is income derived from an incoming producing asset and, as such, does not represent personal services income. By removing the 'act on behalf of' provision in the current bill and re-establishing the 'by arrangement with' of the current Corporations Law, it will allow

the assigning of client lists to the corporate representative and overcome the personal services issue.

Finally, I would like to express the FPA's disappointment with the announcement in the consequential provisions bill for the provision of qualified licences for multi-agents throughout the two-year transition period. While we acknowledge that the intent of the qualified licence is to provide multi-agents the opportunity to continue to provide financial services under the new FSR regime, as either an agent or a principal, we are concerned that both the FSR process and the relevant minimum competency and training standards set by ASIC have been in the marketplace for around three years. Multi-agents have had ample opportunity, like all other industry participants, to put in place systems to meet the appropriate competency and training standards.

The measure as it currently stands diminishes consumer protection by adding another layer of licensing and therefore fails to meet the minister's intent of a single licensing system. It reduces industry competitiveness by allowing multi-agents to operate under a less stringent regulatory environment for effectively 15 to 18 months compared to their peers. The same competency and conduct standards for financial services licensees should be strictly applied to all professional advisers who wish to provide retail financial product advice. By providing multi-agents an effective carve out from the existing competency and training standards, the government is exposing itself to other self-interested lobby groups seeking the same concession at the expense of consumers. Thank you for the opportunity to make our presentation. I am now happy to take questions from the committee.

CHAIRMAN—Thank you. How are the members of your organisation distinguished from the members of the association of insurance advisers in terms of the products with which you deal?

Mr Hristodoulidis—There is not too much difference in the products. The members of our association all hold a proper authority currently with a securities dealer. You are talking about the AFA? They can either hold a proper authority or may operate under the life and brokers act. That is probably the main distinction. Predominantly, in terms of the service they provide to consumers, financial planners who hold proper authority may provide advice on securities products or may actually offer advice on risk products.

CHAIRMAN—And, likewise, they are the same.

Mr Hristodoulidis—Unless of course an insurance person does offer securities advice. Then they need to have a proper authority.

CHAIRMAN—Apart from the issue of commission disclosure on risk products, the other issue raised with us—I do not know if you may have been here—in relation to the insurance advisers was the effect on the commercial value of agencies as a consequence of this bill. Does that issue also affect your members? If not, why?

Mr Hristodoulidis—It has not been an issue with our membership.

CHAIRMAN—Can you explain what the difference is and the structure that makes it not a problem for your members?

Mr Hristodoulidis—The AFA argument was the fact that there would be a downgrading of the value of the asset.

CHAIRMAN—Because their current contracts effectively become null and void when the new bill is passed.

Mr Hristodoulidis—They operate under contracts under the life insurance agents and brokers act, which are different at the margin in terms of the contracts that financial planners operate with the proper authority. Moving across to the proper authority regime, which is the new FSRB we are moving across to, is probably a little bit more onerous and stringent in terms of the requirements. That is where they come up with their decision. We believe there will not be too much change in the way they conduct their business if they have been adhering to our rules of conduct and also Corporations Law requirements.

CHAIRMAN—I was a bit confused by this sentence in your submission in relation to subauthorisation. You say:

Further, while the FPA welcomes the ability for an authorised representative ... to sub-authorise an individual ... the FPA will be seeking clarification as to why an authorised representative ... cannot sub authorise another person.

What is the difference between a person and an individual?

Mr Hristodoulidis—The distinction we are trying to make is that you can have two authorisations. You can have a body corporate that is authorised or a natural person is authorised. The FSRB allows for the body corporate to subauthorise but does not allow the natural person to subauthorise.

CHAIRMAN—Thanks.

Ms JULIE BISHOP—On the training issue, what specifically were your concerns about interim policy statement 146?

Mr Hristodoulidis—There are two main concerns. One main concern is the fact that with the qualified licence a multi-agent who undertakes a qualified licence then has a two-year period to meet the minimum standards of 146, whereas the set date for 146 for all other participants is 1 July next year. If we assume that the start date for the FSRB is 1 October, as the minister has been indicating publicly, that effectively gives the multi-agents who have a qualified licence an extra 15 to 18 months to meet the minimum standards, whereas the rest of the industry is left with 12 months.

Ms JULIE BISHOP—What is the specific problem you see in that?

Mr Hristodoulidis—The problem is that you have got two sets of advisers. You have one set of adviser that is at least qualified to a certain standard and then you have got another set of

advisers out in the marketplace advising on the same products with a lower set of standards or a lower level of competency.

Ms JULIE BISHOP—For a period of time—potentially.

Mr Hristodoulidis—Potentially, yes. But that could be enough time to obviously have a market advantage over those who have met the standards.

Ms JULIE BISHOP—How would you see that occurring? What sort of market advantage is there?

Mr Hristodoulidis—There is obviously a cost involved in getting yourself qualified to the appropriate minimum standards. While most of the industry is running around at the moment trying to meet the minimum standards and incurring costs, the multi-agents are able to defuse those costs over a longer period of time.

Ms JULIE BISHOP—So the cost is not disbursement—you mean a cost in terms of the time?

Mr Hristodoulidis—Yes, the time away from clients.

Ms JULIE BISHOP—Is there anything contained in IPS 146 that causes you any concern—the actual criteria?

Mr Hristodoulidis—We have some concerns with 146 in terms of its application and its interpretation from ASIC. We are working with ASIC at the moment. That is on the issue of where you hold the licence for the certified financial planner—which we have exclusive use of at the moment and it is an international trademark licence. ASIC have made the decision that anybody who has obtained the CFP pre-1995 must undertake some extra formal training, as opposed to those who obtained the CFP post-1995. We argue that the CFP is obviously the highest attainment you can get in terms of your qualifications, and whether you get it pre or post-1995 should not make a difference—especially as one of the requirements of the CFP is that you need to maintain your professional development.

Ms JULIE BISHOP—Just remind me why 1995 is the important date?

Mr Hristodoulidis—We are not quite sure. One of the reasons we think it is 1995 is that there was a change to the course content.

Senator CONROY—In your submission, you state that you are currently analysing the bill to determine the extent to which incidental advice can still be provided under the new bill.

Mr Hristodoulidis—That is correct.

Senator CONROY—What have you found?

Mr Hristodoulidis—As you heard before, there are some provisions there for lawyers to be able to provide incidental advice. I think the issue that I would like to raise here is: what is incidental advice? We have argued, and I know the response by the government to your original report was that what is incidental to an adviser—be it an accountant, a lawyer or a financial planner—may not be incidental to a consumer. I brought today along with me an example of what I am trying to say there. This was printed in the university bulletin in Queensland.

Senator CONROY—Which university?

Mr Hristodoulidis—The University of Queensland. It was a one-pager in the journal. It is a property developer, and they are obviously not licensed because they do not have to be licensed under the current Corporations Law. The first thing up at the top is 'There are four major types of investments'. Then the article gives some descriptions:

1. Term Deposit

Little or no risk and little or no return after inflation

2. Share Market

High risk with varied returns

Ms JULIE BISHOP—What sort of returns?

Mr Hristodoulidis—Varied returns. It continues:

3. Collectables

High risk with huge amount of knowledge required

4. Real Estate

Low risk good long term returns and the basis of all wealth.

Mr RUDD—I am going for number four.

Ms JULIE BISHOP—I like varied returns.

Mr Hristodoulidis—The promoters of the publication obviously are not licensed under the current Corporations Law and will not need to be licensed under the FSRB. But that to me seems to be more than incidental advice.

Senator CONROY—They will not be, did you say?

Mr Hristodoulidis—No.

Senator CONROY—Who has produced that?

Mr Hristodoulidis—It is called 'Investment Bulletin' and it was produced in *Unistyle* up in Queensland. I am happy to table that for the committee. That is the type of thing we are concerned will occur in the marketplace and people will say it is incidental, in this case, obviously, to the property developer. It may be the case that it might be an accountant, a lawyer or a real estate agent. They will say, 'It is incidental to the product I am selling, which is outside the spheres of the FSRB regime, and therefore I do not need to be licensed or authorised.'

Ms JULIE BISHOP—It is a bit bland, though, isn't it?

Mr Hristodoulidis—Not if people rely on that type of information to make decisions.

CHAIRMAN—I think the incidental advice that is envisaged is more in relation to advice an accountant might give in the course of his work as an accountant for a client, rather than direct selling. That document is obviously directed towards selling a product. I think the incidental advice, as I interpret the legislation, is designed to exclude the requirement that someone be licensed if they are just giving advice in the course of their accountancy practice or giving legal advice as a lawyer.

Mr Hristodoulidis—I hear what you are saying. I could quote another example. Say you have been seeing your accountant on a regular basis, and at the end of the financial year you may have a fairly good return coming your way. Suppose that, in the context of obtaining the advice and doing the tax returns, the accountant says, 'The stock market is performing well this year.' Obviously, the natural reaction from a consumer would be, 'Should I be investing in it.' Our preference would be, if the accountant is not licensed or authorised to take the next step, to actually say, 'I'm not qualified in that area. What I can do is say to you, "You need to go and see a financial planner,"' and maybe even refer them to a specific financial planner that is within the local network. A lot of that occurs now, and we think that, in terms of the consumer protection, that actually facilitates a better operation: you would go to see your accountant for your tax return; you would go to see your financial planner for your financial advice; you would go to see your lawyer for any legal advice. If you go and see a financial planner, then he comes under the regime of the FSRB, and all the liability and all the consumer protection regime that is set up by that regime.

Ms JULIE BISHOP—Are you suggesting the liability would attach to that statement that the accountant made, like 'The stock exchange looks good this year', if somebody went along and acted upon that—

Mr Hristodoulidis—No. We are saying that, rather than the conversation going along that way, we would prefer the conversation to go along the following lines: 'The stock exchange is doing well this year'. 'What should I do?' 'You should go and see a qualified financial adviser who is better qualified to give you the appropriate advice given your financial circumstances.' We would prefer that to the accountant then taking the next step and saying, 'Yes, I agree. I particularly think that you should,'—for argument's sake—'be putting it in the resources sector.'

Ms JULIE BISHOP—Unless he is a very experienced accountant investing in the resources sector.

Senator CONROY—How would you respond to a lawyer or an accountant who says they feel the bill curtails their ability to give commercial, legal or accounting advice? For example, they might say, 'Here are some alternate ways to effect the purchase of a company, shares or assets'. Do you think that that was intended to be caught by the bill?

Mr Hristodoulidis—No, we are not saying that that should be caught by the bill in terms of the advice they are giving. We are saying that, when the advice gets into the realm of financial advice, and it becomes advice or dealing, it enters the realm of the FSRB regime.

Senator CONROY—You may not have had a chance to do this. I have had a number of discussions with my friends in the accounting profession. I have sat down with them, looked at their menu of work and tried to work my way through what would be defined as inside. Have you attempted to do something like that? Have you looked at it from their perspective to try and work out what you think would be a reasonable—

Mr Hristodoulidis—We have not actually sat down with either of the accounting bodies to go through their menus and nut out what would fit in and outside the regime. It is probably worth while doing that.

Senator CONROY—I would be interested if you had some advice. I am sure the accountants will happily give their own interpretation when they get a chance to sit where you are. If you had a chance, I would be interested.

Mr Hristodoulidis—No, not at this stage.

CHAIRMAN—No further questions. Thank you Mr Hristodoulidis.

[3.59 p.m.]

LEWIS, Ms Marjorie Gwyllian, National Policy Adviser, Securities Institute of Australia

McCOMAS, Mr Malcolm, Member, Markets Policy Group, Securities Institute of Australia

CHAIRMAN—We have before us your submission, which we have numbered 58. Are there any amendments or additions you would like to make to the submission?

Mr McComas—No.

CHAIRMAN—If not, do you wish to make any opening statement?

Mr McComas—Yes, please.

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

Mr McComas—Thank you for the opportunity to appear today. Our submission is short and to the point, but by way of amplification I make the following comments. First, we believe changes of this magnitude should always be exposed to public comment and industry consultation. We understand that you have received considerable comments expressing concern about the proposed changes and we believe that this reflects an industry position on the proposals. I might also say that my comments today relate specifically to the proposed telephone monitoring provisions in part 2 of schedule 3.

Second, the proposals are, in our view, so broad as to be impractical to comply with and enforce. They would, for example, require recording of a mobile telephone call from a hotel room at 3 o'clock in the morning in response to a chairman's urgent request for contact with a potential white knight who has to be found in an offshore jurisdiction within six hours in order to start the process to solicit a higher and competing offer. Yes, it is impractical.

Third, they would inhibit the free flow of corporate advice to take over participants, which is intended to maximise the competitive environment for takeovers and thereby create value for all shareholders. Advisers are an integral, and some would say key, part of the value added process in a takeover environment. A proposal of this nature that will materially inhibit the wheels of commerce is, in our opinion, bad law.

Fourth, the proposal would not, in any practical way, provide any greater level of protection to small shareholders in regard to misleading or deceptive conduct, the points mentioned in the regulation impact statement. I fail to see how, in practical terms, a telephone marketing campaign run by a telemarketing company could undertake in a serial manner misleading and deceptive conduct. However, if the government wants to regulate something more, then the conduct of telemarketing campaigns would be an easy and deliverable target. This proposal will not prevent shareholders being misled about the fundamental value of a share offered as consideration in a contested takeover; I believe we have adequate protection for that already. This proposal will not prevent deceptive and misleading conduct by promoters in relation to questionable valuation issues or outright falsehoods contained in audited accounting statements.

These issues include, for example, the realisable value of reserves of an insurance company or the contingent and deferred nature of revenues of a mobile telecommunications company.

Ms JULIE BISHOP—Just to take two random examples.

Mr McComas—Fifth, rules of this kind, if they are to extend to advisers and clients, are a world first. It is commendable to aim for world best practice, but let that be in the areas of accounting standards, full and timely disclosure, the enforcement of meaningful management discussion and analysis of financial performance, and rapid and effective enforcement of material breaches of law.

Finally, we also endorse the comments contained in IFSA's supplementary submission that there is a need to rethink the proposal in relation to the practical implementation of the telephone monitoring provisions and that the matter could conveniently be referred to CASAC for further analysis and industry consultations. We thought that was required.

CHAIRMAN—Thank you, Mr McComas. Ms Lewis, do you have anything you wish to add?

Ms Lewis—I am supporting Mr McComas.

Senator CONROY—You outlined the ridiculousness of this particular proposal, so I will not spend too much time on that. As you are a representative of the Security Institute, there are a couple of other areas I would just like to touch on. Mr McComas, I am particularly interested in your view, and the view of the institute, with regard to some submissions we have received from Fairfax and News Ltd regarding the removal of the exemption of financial journalists from needing an investments adviser's licence. Do you have any views on that issue? There is a removal currently in that 77(6) provides a journalist a fair degree of latitude.

Mr McComas—I would support a fair degree of latitude, but it is not an issue that we have specifically looked at or reviewed. I think we have to try to encourage our press to report factual accuracy and secondarily opinion. To that extent, if some degree of regulation at least got them educated on some of the basic financial reporting aspects, I would support it. But I think that in practical terms you have to allow a fair degree of latitude.

Senator CONROY—I understand your point on factual reporting and even opinion. I opened the 'Money' section in the paper on the weekend, and one of the columns was about 'My best three stock tips for you'. Does that fall under 'fact' or 'opinion' in your view, or is that the sort of latitude that you think would be in or out?

Mr McComas—It is invariably reporting somebody else's handiwork—

Senator GIBSON—I want to know what you bought.

Senator CONROY—I continue to have no shares on my pecuniary interest declaration.

Mr McComas—and I suspect that, if it is all their own work, they might be somewhat dishonest in it. So I suspect that it is somebody else's handiwork; therefore, you might have to go back to the original source and see whether that person was qualified to give the advice.

Senator CONROY—Should that column be captured within 'financial advice'?

Mr McComas—I do not think so. Having something reported in the newspaper adds to the investment decision; it does not necessarily create the investment decision. An investment decision, as you know, is always a number of events—it is not identified as one particular event. The shameless self-promotion of tipping sheets is an area of possible concern, and the associated trading activities of the principals of those tipping sheets must be reviewed in the future.

Senator CONROY—I was not going to mention Rene Rivkin today, but now that you have raised him, is there a quantum difference between Rene Rivkin's newsletter and a column in the *Sydney Morning Herald* or the *Financial Review*?

Mr McComas—I use the 'my mother' test in these cases and my mother would probably defer to some more general advice rather than rely just rely on a tipping sheet.

Senator CONROY—Putting aside Mr Rivkin's exploits—and I am not trying to suggest that he is not reputable—what about other reputable tipping sheets that may get reproduced in a newspaper? You have suggested there is some latitude and you thought that was a good idea. Do you think there is a line to be drawn here? I am just trying to find a line.

Mr McComas—I do not think it is a clear line in the sand at all. I think you really need to just go to the practical losses incurred by people who follow those sorts of tipping sheets—if, in fact, they do incur losses. I think somebody who takes a punt on some of those things is actually investing a small amount of money in those projects. Somebody with any significant amount of money to invest, I think, will actually seek several points of advice and, hopefully, take his own counsel on those issues and invest wisely.

Senator CONROY—So the size of the potential loss should be a factor?

Mr McComas—I think so. I do not think that somebody is going to take—for example, to pick a number—a $250,000 betting plunge on the basis of a tipping sheet alone. He might take 250 shares traded over an electronic brokerage system with minimal brokerage and commissions, but I do not think he is really going to invest substantial funds—by that, I might say more than 15 per cent or 20 per cent of his entire investable worth.

Senator CONROY—This question goes to comment, analysis and opinion. I think Trevor Sykes did an important piece on the BHP-Billiton deal where, after some analysis—which you described as 'on the back of an envelope'—he then recommended against accepting the deal. Does that fall within 'financial advice'?

Mr McComas—Again, it is not an area that I want to pursue specifically today. But, by way of general comment, I would say that there are about a dozen highly qualified, experienced, mature financial commentators in the Australian press. Probably some of the leading ones are

based in Melbourne. They tend to comment on the facts after due consideration. They have a broad range of contacts that they talk to in the informed financial investment community and, invariably, they are pointing out the pitfalls or the gloss attributed by the promoters to those particular projects. I think they perform a very valuable, commendable service. I would not want to see Trevor Sykes go back to school or to requalify.

Senator CONROY—I look forward to being the person who told him he was! The FSR Bill will amend market offence provisions. Do you have any concerns with several of the market offence provisions, including the continuous disclosure regime and the insider trading provisions, becoming civil penalty provisions?

Mr McComas—Again, it is not an issue that we have looked at specifically, but I see no barrier to the extension of false and misleading statements or insider trading to civil penalties.

Senator CONROY—Can you explain the difference between an obligation on a licensee to act 'competently and honestly' and an obligation to act 'efficiently, honestly and fairly'?

Mr McComas—No.

Senator CONROY—Do you think they are the same thing?

Mr McComas—I have no view.

Senator CONROY—Okay, thank you.

Ms JULIE BISHOP—Going back to your submission, it is self-evident that the telephone monitoring provisions are there because of the increased telephonic communication with target shareholders. Given the increased use of that form of communication, particularly with professional communication companies, does that not increase the potential for there to be possible breaches of the Corporations Law, in terms of misleading deceptive conduct specifically?

Mr McComas—I do not believe so. It is interesting to understand the process of the appointment by a bidder or target company of a telephone marketing campaign to support their acquisition campaign or the defence trail. It is usually by way of appointment of probably one of half-a-dozen leading telephone-marketing campaigns. Those telephone campaigners are anything from out of work actors to telephony people. They are given a script. They are not allowed to deviate from it except in minor or trivial ways. The offeror vets that script. He takes responsibility for it. It is usually vetted by his advisers and lawyers and other interested third parties. It is an intensive review process. In my experience, the results of those telephone campaigns are not necessarily indicative of the outcome of a takeover offer or a particular rewarding in advice.

Ms JULIE BISHOP—How can you be sure that they stick to the script?

Mr McComas—That is usually monitored by a controller in the same way Telstra 013 numbers are monitored. I would imagine that some of the more sophisticated organisations do record some of this data anyway. If they did not, it would not be a great step—as security

houses do monitor trades—to monitor those sorts of calls as well. I do not think a lot of damage is being done by market solicitation. Again, using the 'my mother' analogy, my mother does not give advice to those companies.

Ms JULIE BISHOP—Your mother in this instance is one of the telemarketing operators?

Mr McComas—My mother in this case is the investor in securities.

Ms JULIE BISHOP—But, just in terms of the difficulty in establishing whether or not breaches have occurred, what is the downside of having a telephone conversation where the possible breach could have occurred being recorded?

Mr McComas—I am not sure what breach can be recorded, because they usually focus on repeating the facts contained in a published document, being the offer statement or the response document. Invariably, they might go to look at some qualitative issues around the investment. As you know, Shell conducted a major campaign in its efforts to acquire Woodside. I believe they used telephone monitoring in that campaign. That was more of a subjective nature to actually understand what investor sentiment was towards the stock and potentially the stock price. I believe that would have been fairly carefully regulated by advisers. I do not believe that they are necessarily giving advice or would contemplate giving advice to accept the offer, other than in a qualified way by confirming they are acting for a bidder and confirming they are soliciting you to accept a takeover offer.

Ms JULIE BISHOP—If the information contained in the public documentation from which the script is taken is misleading and deceptive, isn't the telephone script another example of the breach? It is more evidence of the conduct of the company?

Mr McComas—It is good evidence, and evidence that I would imagine would be sufficient alone to create that link with deceptive and misleading conduct. I think the response is irrelevant.

Ms JULIE BISHOP—There was a suggestion that target companies and their agents be prohibited from communicating by phone with target company shareholders during the course of a takeover bid. What do you say about that?

Mr McComas—I do not support it. I think it is a free market. Again, if you are an investor in a takeover target company, you are seeking advice, whether it be from Senator Conroy's tip sheet, a broker, friends or relatives—wherever it may be, you are seeking advice. If one element of that advice is a response from a telephone marketing campaign—if you have the time to take the call and listen to the questions—I do not see that it creates any great or meaningful harm.

Senator MURRAY—Rather than this black-letter law proposed with regard to the specific issue of telephone monitoring, if the government is reacting to a perceived problem or concern, wouldn't the first step—rather than consultation and all that, if they want to deal with it—be to simply ask ASIC in terms of its general abilities to provide some guidelines in this area, in consultation with people like yourselves, so that the interaction does not turn an investor into a victim, because that is the assumption? It seems to me that it is a very big hammer for a rather small nail. There might be a need for some kind of general guidance in this area.

Mr McComas—There may be. I think it is a very interesting point that you raise. I am sure that could be negotiated between, for example, CASAC and ASIC or direct with ASIC. ASIC's guidelines are generally supported by the investment community it represents. It is a line in the sand, to use an analogy, between what is acceptable practice and what is poor practice. They take counsel from international precedents as well. I think it would be a very good initiative if it were felt that there were material breaches of conduct or territory which steps into false or misleading conduct. But I am not convinced that there is that conduct going on yet or that naughtiness being created by the telephone campaign marketing people.

Senator MURRAY—The telling point that you made to me was that there are relatively few people who do this. It always seems to me that guidelines and rules of engagement work best when there are relatively few people that you have to tell about these things. What you said is that, regardless of the company and the event, there are not many more than, say, six marketing outfits who would be equipped to do this kind of job. It is not difficult really to persuade them as to how they should conduct themselves and, if there remains a problem after that fails, then I would have thought that you look to black-letter law.

Mr McComas—I imagine that they could also come up with a self-regulatory set of guidelines which could be adopted by ASIC or approved by ASIC. It would not be an onerous step. They probably have a set of guidelines already under some advertising code.

Senator MURRAY—Right through our system, we have voluntary codes of conduct, if you like, which are established between a regulatory authority such as the ACCC and an industry, and if that is proven not to work that is when you move to mandatory codes of conduct. To me, this has missed out the intermediary step.

Mr McComas—I agree completely. I think all your comments are absolutely valid.

Senator GIBSON—In Mr Willis's letter to us, he says:

> We are extremely concerned that telephone monitoring could severely inhibit takeover activity in this country and establish a precedent for further unnecessary intrusions into an already heavily regulated industry.

Would you care to expand a bit about the risks with regard to takeover activity?

Mr McComas—We are regulated in this country to a great extent, whether it be in public company takeovers or the issuance of securities. There is general concern amongst the industry which the Securities Institute represents that this represents yet another piece of legislation to comply with. If we did not have legislation but rather had principles established that were adopted by the small number of participants in this industry, it would be a lot more convenient than having to comply with yet more legislation. I think that is the key point he is trying to make.

An interesting point you do raise, though, is the unregulated area of private company acquisitions and divestments. There is a substantial amount of commerce done in Australia in this area, which of course is not a total free-for-all—far from it, as all the fair trading rules apply to this area as much as anything else. There are many large and substantial enterprises within Australia which are bought and sold on a daily basis, by number far exceeding public company

takeovers. There is this fascination, if not paranoia, with public company takeovers, and very little is said about the very large private companies that trade hands on a regular basis.

Senator MURRAY—Or about the shonky practices that survive despite all the law.

Senator CONROY—You headline grabber, you!

Senator MURRAY—I am experienced in that world, and I can tell you that out of every 10 deals, there are three or four shonks.

Mr McComas—And there are about 18 that do not ever complete.

CHAIRMAN—Are there any questions? There are no further questions. Thank you, Mr McComas and Ms Lewis.

[4.22 p.m.]

BEEBY, Mr Warren Rees, Group Editorial Manager, News Limited

EISENBERG, Ms Julie, Head of Policy, Special Broadcasting Service

FLYNN, Ms Julie Patricia, Chief Executive Officer, Federation of Australian Commercial Television Stations

WOLPE, Mr Bruce, Manager, Corporate Affairs, John Fairfax Holdings Limited

CHAIRMAN—Welcome. We have before us submissions from Fairfax, the Federation of Australian Commercial Television Stations and SBS. I think we have also received a submission from News Limited. Are there are any additions or amendments to your submissions?

Mr Wolpe—No, there are not.

Ms Eisenberg—My submission is also supported by the ABC.

Ms Flynn—The FACTS submission is also from ASTRA, the pay television industry organisation.

CHAIRMAN—If you wish to make an opening statement, you may proceed and then we will move to questions.

Mr Wolpe—I originally spoke with the committee about appearing this afternoon, and my colleagues from other media organisations and trade associations wanted to join us. We appreciate the committee accommodating all of us so late in the day and we apologise for taking up your time so late in the day. We will be brief.

This is not an issue that we sought and, indeed, until last month we had no idea it even existed or was a threat to our business and financial journalism in Australia. Once it was apparent that this issue existed and that it would require an amendment to the bill to rectify, we immediately contacted this committee—and I appreciate, Mr Chairman, your inviting all of us to be present here today. I also want to thank the drafters of the bill for making possible a degree of unity in the media industry that has never existed before on a legislative issue. We are apoplectic with joy at being united at last.

The issue can be simply stated. The Financial Services Reform Bill repeals section 77 of the Corporations Law. That provision of existing law gives a presumption of an exemption to the media to be licensed as investment advisers. This proposed repeal has caught us all by surprise. We did not know about it and, in the course of my conversations with many members of the committee, it appeared to catch many of you by surprise as well. There is a reason for this. There is no reference to repeal of the media exemption in the explanatory memorandum of the bill in the second reading speech, in any of the voluminous materials prepared to explain the bill and, to this day, there is still nothing on the record that explains why this repeal is in the bill. There is also no record supporting repeal of the media exemption.

Firstly, the entire FSRB, all 550-odd pages of it, is based on the exhaustive work of the Wallis inquiry. There is nothing, to our knowledge, in the Wallis report on this issue. There is no call for repeal of the media exemption in Wallis. Secondly, ASIC itself supports retention of the existing media exemption in the law. ASIC says this explicitly in policy statement 118, and senior ASIC staff represented this point again to our counsel last week. We appreciate ASIC's support. Thirdly, the current system works well. The law is clear; the regulations are in place; they function clearly. Fairfax has never been notified by any regulatory authority of any deficiency with respect to how our journalists operate in the context of the Corporations Law.

In short, we do not believe it is broke, and therefore it does not need to be fixed. No other developed country, and certainly no democracy, requires its journalists to be licensed. This is dangerous territory, particularly when we are proceeding down this road inadvertently, to say the least. My colleagues from Reuters—and they have made a submission to this committee—also point out that any such licensing requirement may well be in violation of Australia's responsibilities under the WTO's General Agreement on Trade in Services—GATS. I do not believe that the drafters of the bill have appreciated the importance of this issue, and I commend the Reuters submission to you.

We are most respectfully requesting an amendment to the bill that restores the media exemption. We believe it would be best to have language that generally tracks existing law. We can provide such language to the joint committee for your review and discussion, and we are in discussion amongst ourselves on that. We need the exemption to be restored in the law itself. Ministers come and go, and regulators come and go. It is much harder to change a law than it is to change a regulation. Rights in law are rights that endure. An issue of such fundamental importance to the integrity of press freedom in the public interest deserves no less than protection in statute. I cannot understand why anyone would choose this particular moment to discourage robust coverage of corporate and financial news in this country, which is exactly what repeal of the media exemption does. Let me be clear, enactment of a bill that removes from existing law an exemption for the media is an irreparable step backwards for the protection of journalism in Australia—journalism that serves the public. We can discuss language, but what is critical is that the protections be contained in the new law. It is for these reasons that we have turned to you, the members of this committee, to do that. I believe my colleagues may want to add a little something.

Mr Beeby—I would like to say a few general things that will top up what my colleague has said. Basically, from the News Ltd perspective, we are concerned always about attempts to curtail the freedom of the press. The Constitution itself has no guaranteed press freedom; it has no first amendment and we have no bill of rights. The only rights that the press has, in reality, are those that legislators do not take away from us, and this bill proposes taking something away from us.

It is my understanding that the same sort of legislation was put up in Britain recently and the government looked at it very closely after consultation with the media and it was decided there not to press ahead with provisions to license journalists on the basis of press freedom having precedence over desires to license or control journalists. I do not think there is much more I can add to it than that. As my colleague said, the industry is unanimously united against moves that would lead to the licensing of journalists. We see it as a grave threat to press freedom and we

appeal to you to have a close look at it and see if there is not another way that can be found to get around it.

Ms JULIE BISHOP—I have one question to clarify what Mr Beeby said about the British scenario. Was that an exemption scenario or was it a proactive piece of legislation designed to license journalists?

Mr Beeby—I am sorry I do not have precise details of it.

Mr Wolpe—As I understand it, I received some information on this this morning from Reuters, who followed this more closely as a UK-based company. It was a financial services overhaul similar to this and there was an exemption put in the bill—I have language on that—to carve out the media from general licensing requirements.

Ms JULIE BISHOP—So there was no exemption in their bill and the British government have now put an exemption in, is that what you were saying?

Mr Wolpe—Right.

Mr RUDD—So in the past there was no exemption.

Mr Wolpe—No. I think as they modernised the law they kept an exemption.

Senator GIBSON—Have you got the exact words in the bill?

Mr Rofe—Yes, I do.

CHAIRMAN—Would you care to table that?

Mr Wolpe—I do not have any problem with that.

CHAIRMAN—Ms Eisenberg or Ms Flynn do you wish to add to the opening statement?

Ms Flynn—Yes. We are concerned about taking out a statutory exemption and introducing a complex set of regulations which potentially create more grey areas than currently exist, allowing for the fact that currently there are circumstances under which people are licensed. Again, we note the comments from Mr Wolpe that there is nothing in the explanatory memorandums, it is not in the Wallis committee reports, there has been no public consultation and, as far as we can see, no demonstrated need.

In practice, however, I note that removing the statutory exemption and replacing it with a case-by-case consideration of the guidelines will create great uncertainty that will result in either less information being made available to the public. Bear in mind, particularly in a radio and television scenario where these decisions are being made on the run all the time and you have a 24-hour news cycle, if you are in a situation where there is this level of uncertainty you are not going to publish, it is as simple as that. Or, you are going to have to set up the mother of all bureaucracies to run this. How many hours a day is it going to be serviced? Which parts of

the country? How many radio stations, television stations, newspapers, on line services, et cetera, are going to be picking up a telephone?

There is a third option and that is it will create a whole new business for the lawyers but it does not at the end of the day seem to be terribly practical. I refer back to the fact that we are not aware of where this demonstrated need is. We tried to do some tracking back to the original exemption, section 77 of the Corporations Law, and we have been able to track it back to the Securities Industry Act 1970. At this time, the bills were not accompanied by an explanatory memorandum and we have not been able to access any of the parliamentary debates in the time available or speeches of that time. Later explanatory memorandums to subsequent legislation containing the exemption merely state what the exemption is and do not provide any policy reasons for its existence.

However, what we would argue from this is that the exemption has been around for a very long time through successive pieces of legislation and needs strong policy justification for its removal. I will pass this one on to my colleague who was responsible for finding it, which is an example which Julie will no doubt talk to in another section.

Ms Eisenberg—Yes, I will have some other points to make on behalf of the national broadcasters but following on from this point, there is an interesting analogy. When we look at this provision when it was first inserted into corporations legislation there was obviously a clear policy goal though we have not been able to get the precise words to it. But, in an analogous situation, in 1975, the government enacted the Trade Practices Act which, amongst other things, made organisations liable for misleading and deceptive conduct. In the early 1980s it became apparent, as a result of a couple of cases, that people were suing the media for misleading and deceptive conduct. It was seen as being of such great concern that, in 1984, parliament introduced section 65A which was a broad media exemption.

Ms JULIE BISHOP—Australian ocean lines and Western Australian newspapers.

Ms Eisenberg—That is exactly right. It was following reports of a cruise ship which had a very unfortunate experience.

Ms JULIE BISHOP—The good old daily news.

Ms Eisenberg—Without diverting too much, apparently, a number of passengers on the boat complained that the service on the boat was terrible and a number of the people on the boat, who had been there as journalists on promotional trips at the hospitality of the owners of the boat, said that it was perfectly fine. A case was run and it was found that the newspaper had got it wrong in reporting that there were problems on this cruise. The newspaper was found to be responsible for misleading and deceptive conduct. This was seen as posing a great threat to media independence and potentially inhibiting media in reporting factual material, because the slightest mistake could create liability.

Senator CONROY—Can I just clarify; Did the newspaper say there was poor service or good service?

Ms JULIE BISHOP—The newspaper headline said 'Nightmare Cruise' and as a result of the headline, 'Nightmare Cruise', the shipping company says that it went broke. Therefore, the newspaper had relied on the journalists saying that that was what passengers had said. So it was a question of going back and finding a passenger who had said to a journalist that it was a nightmare cruise. Subsequently, no passenger admitted to ever having said that. I thought the company was actually found liable in defamation.

Ms Eisenberg—As well.

Senator CONROY—I was going to say that it is a libel issue.

Ms Eisenberg—Yes. There was liability, both in defamation and under section 52. But what came about as a result of that, and another case, was that it was seen to create, potentially, a very great fetter on the ability of the media to report factual material where it was not able to verify every single detail. As a result of that, in 1984, section 65A of the Trade Practices Act was inserted. I have a copy of an extract from the second reading speech. In essence, they said that, when the media is being the media, when it is simply reporting information, it should not be financially liable to members of the public if it makes a mistake. If the media is acting as a commercial entity—for example, it is advertising—it will be subject to the provisions of the Trade Practices Act.

If you shift the analogy across to the section 77 exemption, the position here, all we are trying to argue for is that, when the media is being the media, it should not have to be licensed. If the media does, for whatever reason, get involved in financial advice—and there are certain programs, I believe, for example on the Nine Network, where it does get over into that territory—then everybody is quite happy with falling in under this. But, when the media is simply being the media, to subject it to a licensing system which requires training programs for employees, a whole lot of prudential requirements—a huge administrative burden—it just does not make sense at all.

That is evidenced by the fact that it does appear to have been changed incidentally without any consideration. We believe that, if this had been thoroughly considered, the existing media exemption would have been left as is. I will hand up an extract from the second reading speech for the introduction of section 65A into the Trade Practice Act.

Ms JULIE BISHOP—Is that the information providers?

Ms Eisenberg—Yes. That is the information providers exemption. I would like to make a couple of minor comments from the perspective of national broadcasters. From our perspective, and from the ABC's perspective, this creates an even bigger issue for us because both of our enabling acts give us editorial independence from government. And that is something that is regarded as being a matter of great importance. Earlier this year the government was—

Mr RUDD—The legislature has that view as well.

Ms Eisenberg—That is correct and it is apparent from the second reading speech introducing our legislation. It is apparent that earlier this year the government amended some of the datacasting legislation to ensure that the ABC and SBS retain the ability to independently

develop codes of practice for datacasting activities rather than being under the licensing system with the Australian Broadcasting Authority, which commercial datacasters are going to be subjected to. The reason for that is that it has traditionally been seen as undesirable that the government gets involved in determining the editorial content of national broadcasters.

We are particularly concerned that this legislation has the potential to subject ABC and SBS editorial decisions to a licensing system in terms, which Julie Flynn described, of having to ring up ASIC all the time and ask whether or not they can publish something. That would be completely contrary to the spirit and the intent of our legislation. We would like that to be taken into account as well.

CHAIRMAN—Thank you very much. Earlier today we tabled correspondence from the minister which indicated that the issue could be dealt with either by an exemption being made through the regulations or by means of ASIC's exemption powers. The government is considering those options. Can you tell me why that, from your perspective, would not be satisfactory, rather than the exemption being part of the legislation? I know you did refer to it.

Mr Wolpe—The removal of an exemption from existing law is a step backwards as far as protection of the media is concerned in this instance. ASIC has powers today. An exemption is not absolute; it is a presumption of an exemption. There are ASIC rules today that govern that exemption and there will be ASIC rules tomorrow. We will be in an ASIC rule-making process regardless. It is where the burden and the onus lies. Under existing law we have a presumption that what we publish for general information, generally available, is exempt.

Mr RUDD—It is presumption.

Mr Wolpe—It is a presumption. That is all it is. It is not absolute. But if that is removed then suddenly we have to bear the burden of showing that in fact we should not be regulated. We think it is a balancing act. What do you value, taking into account everything that needs to be done by the media for consumers and so forth? We think a new bill that removes a protection in existing law is a decisive step backwards for media freedom in the country.

CHAIRMAN—Ms Flynn, you indicated the difficulties that would be caused, particularly to the electronic media, with making decisions about broadcasting stories and so on. Is that the issue? Isn't the issue whether the journalists have to be licensed? Once they are licensed they would be free to make their comments.

Ms Flynn—There seem to be different circumstances under which you would need to be licensed. There are different situations, aren't there? If, for instance, you publish in one area you might not need to be licensed but if you publish somewhere else you would. It does create a lot of grey areas. By reversing the onus you presumably then have to seek confirmation. In practice what that will mean is that people will either just not go there because it is too hard, and your internal lawyers will tell you not to, or you will find yourself constantly having to pick up a phone and check with some bureaucrat somewhere as to whether that means that you can run this or not.

Ms JULIE BISHOP—Not if you are licensed though.

Ms Flynn—Then you get back to the whole thing about licensing the media. Until February this year I have spent virtually my entire career as a practising journalist. I have to tell you it gives me the shivers, because I think that once you start in an area like this you really are starting to move into areas that have been seen as being quite separate. That is allowing for the fact that under the existing regulations there are certain people who, if they have another business, are licensed. We are not arguing about that. We are talking about the fact that suddenly you are saying, 'All these organisations have to be licensed.'

Ms JULIE BISHOP—Only if they are doing certain things. The legislation is not saying that they have to be licensed. It comes down to what they are actually doing: if they are giving personal advice or generic advice.

Ms Flynn—Yes, but whose interpretation is that?

Mr RUDD—I suppose that is my concern too. De facto, what we seem to be ending up with is the creation of a capital 'R' rather than small 'r' regulator-general of the media, because at the end of the day someone has to make the primary decision—and it will inevitably be a bureaucrat, presumably within ASIC—that X's behaviour, as a general media practitioner, is consistent with the provision of financial services advice. We all know, as consumers of the media, that there are people who provide economic commentary, there are people who provide public finance commentary, there are people who provide corporations commentary, and there are people who provide particular securities commentary and there is a great overlap between all of them, including within a single piece of commentary.

I think there is a foundational issue here which is not just the altering in terms of the presumption but—and this is what I find most burdensome in my reading of the documents—how actually it will be operationalised. The discretions which would be allowed to the regulator-general of the media hanging out there in a nice office in ASIC somewhere is something which I find a bit puzzling.

Ms Flynn—Absolutely. If I could just go to the question of contributors, it might be that a radio station or a television network—and a television network is a good example—does not actually employ the person. It might not be an on-staff person, but rather a contributor or a person who appears on a program. Someone might appear on the *Today* show; someone might appear on the *Sunday* program—

Senator CONROY—Is Paul Clitheroe running a business or is he a business journalist?

Ms Flynn—As far as he is business, he is licensed to cover it. We do not have any issues with journalists.

Mr Wolpe—Under the existing rules today, if there is any activity in the media that prompts a concern, ASIC has the power to investigate it and resolve it. Again, it is not absolute and we are not asking for anything absolute.

Ms Eisenberg—On the question of 'Why not get a licence?' it again comes down to what sorts of activities you are doing and how regularly you do them. For example, SBS runs a radio station which has 68 separate language programs, with 68 separate presenters. They are not

business programs but, in the course of them, there may be issues which come up about advice or giving opinions or whatever, so the question becomes: does SBS then have to get a licence? Does it have to run regular financial advice training programs for every one of the 68 broadcasters, on the off-chance that one of them might down the track raise an issue which might breach one of these very unclear regulations? They might ring up ASIC and ASIC might say, 'Yes, we think you are going to have to be licensed to do that.' It leads to quite an absurd situation when the core of your business is not giving financial advice. But because of the way that the exemption has been reworded, things which might not have been previously regarded as financial advice now may fall within the definition and outside the exemption. That is the real problem for us.

Senator CONROY—Is it possible for you to attempt to ensure that people who come on your programs or write in your newspapers giving financial advice are registered or licensed? You could make a corporate decision that says, 'We will only have Paul Clitheroe on telling people how to invest their money if he is licensed.' If Paul does not have a licence, then Paul has a problem.

Ms Flynn—I think that that is how it works currently. If he already has a business which does that specifically, he does have to be licensed.

Senator CONROY—I am picking an easy example. I have a million others that are not as easy.

Ms JULIE BISHOP—Go for a greyer example. That one is too straightforward.

Senator CONROY—In terms of a recent—

Ms Flynn—Then you get back to who is making the call on this.

Senator CONROY—We are saying that it is the corporation that is going to put it to air, so that you have a policy that says, 'You cannot come on and give financial advice. You cannot be the *Today* show's financial adviser.' And it does not have to be Paul Clitheroe. You cannot be Channel 7 and David Koch unless you have got—

Ms Flynn—So that rules out your interviewing anyone who may have—

Mr Wolpe—Expertise?

Ms Flynn—Expertise is the word I am looking for. That is right.

Senator CONROY—Hopefully you are getting a licensed expert. That is the point.

Ms Eisenberg—It is also okay in a situation where it is clear that what you are giving is obvious financial advice, but the difficulty with the new regulations is that it is not clear what is going to be financial advice and what is not. It is the grey areas where this is a trap—where you have someone on a program who is not necessarily wheeled in as a financial adviser but, in the course of the discussion, find themselves giving that sort of material.

Senator CONROY—Inducing a person to deal in securities is relatively straightforward.

Ms Eisenberg—That is a straightforward example but there are many that are not.

Senator CONROY—Alan Jones saying, 'Invest in this property deal'—is that giving financial advice, especially since he has been receiving money to make a suggestion like that in a cash for comment situation?

Mr Wolpe—Let us leave cash for comment out of it.

Senator CONROY—Alan Jones was paid money to advertise a property development. That is financial advice. He said, 'This is a good financial deal. Go and invest in it.'

Mr Beeby—In that case, I say he should be licensed and I have no qualms about that.

Mr Wolpe—If someone is getting financial benefit from the advice they are putting to air, they should be licensed, absolutely.

Mr Beeby—Can I just add a couple of things about newspaper functionality and the way journalists operate? They are not all categorised experts in the field of shares, interest rates or whatever. They interview people from a broad spectrum of political and business life, covering all manner of things. They never know from one moment to another who they will be interviewing next. It might be the minister for communications extolling the virtues of Telstra 2—heaven forbid! A straight report of those comments might be construed as being investment advice. That is the sort of thing that a journalist anywhere can find themselves dealing with.

Senator CONROY—Just talking about cash for comment, I think there is the other extreme. We have got Paul Clitheroe and Alan Jones taking money to advertise a product on radio. They are the two extremes.

Senator GIBSON—I do not think they are in the same sort of category.

Senator CONROY—We recently had a major debate in this country about BHP Billiton, on which Trevor Sykes did an excellent column. He did some analysis of the material supply and made a recommendation about whether or not BHP shareholders should accept the offer. I thought it was a very important piece of journalism. Does that constitute giving financial advice?

Mr Wolpe—He is not in the business as a financial adviser. He is in the business as a journalist. Journalists have informed opinions and they communicate them, which is what the purpose of newspapers are, in part. I do not believe that he should be licensed in order to write that column.

Mr RUDD—That opens up the interesting and parallel question of how we currently operationalise PS118 under ASIC policy statements in terms of how the current application of licences operates. What sorts of considerations does ASIC currently apply in giving effect to those who plainly provide this advice at present as the sole or principal purpose? Presumably

that is an easier test for an ASIC operative. If you are looking at the body of Sykes' commentary, is it a minor part of his overall commentary that he would end up providing something which is of direct relevance to individual securities matters? I presume these are the sort of criteria which rock through the mind of ASIC regulators at the moment, looking at the current policy statement. But then there is a much broader canvas, which is opened up by the change, I presume.

Mr Wolpe—Yes. The proposed ASIC rules actually do that. They look into the content. Instead of functional classification, it is content classification, and that is very disturbing to us.

Mr RUDD—What I am puzzled about is this. I have actually read the minister's letter. He did not write to me. He wrote to you. This is Minister Hockey. Have you folk seen this letter? It has now been tabled, so I am sure it is a public document. At the second dot point, referring to the Financial Services Reform Bill 2001, it says:

However, it is not the government's intention to change the practical effect of licensing requirements for media organisations. Essentially the same activities will require to be licensed as under the current regime. It is proposed to make an amendment to the explanatory memorandum to clarify this effect.

This goes to my question in a way, and it is an open question. Perhaps Senator Chapman can enlighten us a bit. If that is seriously the statement of the executive's intention, then why are we changing the current language?

Mr Wolpe—We agree.

Mr RUDD—My question earlier on was going to be—

CHAIRMAN—Are you directing a question to me, Mr Rudd?

Mr RUDD—In a way I am.

CHAIRMAN—I am not here representing the executive. I am here as chairman of your committee.

Mr RUDD—I thought we would play that procedural game. But you might be mindful from time to time as to what might be in the mind of the executive. I came here today with the plain view that the minister was contemplating a change—that is, that the practical effect of what was being canvassed would be different. But this is now new to me.

Ms Flynn—It is new to us too.

Senator GIBSON—The central point now is that the government have signalled they are providing a route out, which you had requested. The only argument is whether it is in statute or by regulation.

Mr Wolpe—I think there is a threshold question as to whether there is language in the statute. We believe such language is essential.

Senator CONROY—Kevin jumped in and interrupted me. I wanted to try and give another example to see where your thoughts were on this issue. I opened up the 'Money' section on the weekend. I cannot remember the name of the journalist, but it said 'My three stock tips'. Is that financial advice? Is it inducing someone to deal in a security?

Ms Flynn—Or journalist's opinion?

Mr Wolpe—In the context of the publication, no, I do not believe so.

Senator CONROY—Is there anything that a journalist could do that would in your view be giving financial advice, other than Alan Jones taking cash for comment?

Ms Flynn—Can I refer back to the cash for comment? That was handled by the ABA, and the ABA did put a series of rules—

Senator CONROY—Very serious rules! They are well respected!

Ms Flynn—Respectfully, I would argue with you, but perhaps we could have that conversation quietly some other time. But there is now a disclosure regime in place and it is being very carefully monitored. It is being applied more broadly across the radio industry as a result of that inquiry. Certainly in relation to television we have no demonstrated history of any of these exemptions or things like it having been queried, having failed or having had any demonstrated need for change in the past. Over the last 30 years that that exemption has remained in place, which is as far back as we have been able to track it, there has not been a situation where that has been called into question or where the television industry—

Senator CONROY—To come back to the first part of my question, is there nothing that a journalist does that would in your mind constitute financial advice?

Mr Wolpe—If the person is in the business of providing financial advice and is remunerated on the basis of his or her recommendation—they are getting commission on a recommendation, they have a business on the side that would process the recommendation that is being made, or in any other way participate in the consumer participating in that business—that person should be licensed. But as a journalist—

Senator CONROY—So you see that as a threshold?

Mr Wolpe—It is a functional difference.

Mr RUDD—But somewhat different from what we just discussed. Sorry to interrupt.

Senator CONROY—You are not really sorry!

Senator MURRAY—By the way, there are two of us down here ahead of you.

Mr RUDD—This will be my last intervention from up this end. I have been silent for a lot of the afternoon. Looking again at the core operational clause of ASIC policy statement PS118, the

threshold test there is whether the provision of that advice constitutes the sole or principal purpose of the provider of that advice. It has nothing to do with running a business, as such. If that is what is we are talking about, then we need to be quite clear about that, because it seems to me that that emphasis and that weighting contained with that provision is of a different character from that which is afforded by the operationalisation of the new provisions which are canvassed for the act.

Senator CONROY—I am trying to get some of the classifications in my head. The magazines *Asset* and *Personal Investor* and a string of what would loosely be called financial market journals of one sort or another, targeted obviously at different sections—would any of them give financial advice or would all that be under your heading of 'comment'?

Mr Wolpe—They are general publications which are generally available and they fall under the ASIC rules as not requiring a licence. There are specialist publications that we have, with very narrow subscription bases, that are licensed.

Senator CONROY—Subscription bases. I understand that.

Senator COONEY—I thought originally that what you really wanted was an exemption from the rules that applied to everybody else. I always think that that is a bit invidious—one section gets an exemption where others do not. This may only be a play on words, but it might express what you really want. You do not want to be brought within the ambit of the act, rather than being exempted. The reason I say that is that, when people say to you, 'If someone who is a journalist gives advice, then that person is caught by the act,' what you want to be assured of is that, if a person is operating as a journalist, he or she is not fortuitously caught in some way. That seems to be a way to look at it. It makes your position seem much fairer. You really do not want to be brought within the ambit of the act, and you want that made quite clear. It is not as if you want to go around giving advice that other people are regulated for. If you give advice and everybody else who gives that advice has to be licensed, then you say, 'Yes, we will be licensed too.' But if in the course of your proceedings the doubt arises, you just want to be rid of that doubt.

Ms Flynn—I think part of the problem is that under what is proposed you are talking about the applicability of rules on a case-by-case basis. That is where it really becomes difficult. It creates all sorts of grey areas, and that is where we were referring—

Senator COONEY—You want a direction to the court that if a journalist comes up as a journalist, that is it. Can I just ask a propos of that—because I think it makes a bit of a difference—I thought your original proposition was that it is so important to preserve the freedom of the media, no matter what it does and whether or not it gives purely financial advice, that it should be exempt; but that is not your position.

Ms Eisenberg—We just want to preserve the status quo. We have already got the benefit of an exemption; we just do not want to be worse off, and in a worse position than we currently are, under an exemption which we believe balances the protection of consumers against media freedom. We believe that the new provision actually swings against the media, and that it works to our detriment.

Senator COONEY—But it is really not an exemption.

Mr Wolpe—It is a presumption.

Ms Flynn—We have also referred to some of the free-to-air programming matters. I should make note that two of our pay TV colleagues who are partners in this submission argue—and unfortunately Deb Richards from ASTRA cannot be with us today—that the channels that will be affected in pay television—and they see it as having a real, direct impact on them—include Sky News, CNBC Australia, Bloomberg, CNN and BBC World. When you think about the products from all those programs, you begin to realise how wide-reaching this case by case thing could be.

Senator MURRAY—I think you have got to go back to the heart of the matter. The legislation is designed to say that anyone who gets a financial benefit, which therefore would influence the advice they give, should be appropriately licensed or appropriately declared. It is clear to me in your answers that anyone who is paid to give advice—either through a business and then they write guest columns for a newspaper, or through a hidden commission such as that vile and immoral cash for comment business—should be licensed as a financial adviser. No problem. The difficulty is the indirect inducement. A journalist who is given a free weekend in a new resort somewhere and then writes it up as a good place to buy a time share: should they be licensed? My view is that they should not. They should simply declare it, and I think the rules under which journalists operate say that. However, there is a third, difficult category, and that is boosterism. It has been picked out in such programs as *Media Watch*. The major media companies are now conglomerates, big business organisations which have lots of other interests, and you see shows which boost films, which happen to be produced in the other side of the media businesses or companies, or whatever. And boosterism is not where the journalist gets an indirect inducement or benefit, but where they feel obliged to support or promote a particular position; that is where there are some difficulties. I am inclined to a different view: do not regulate them through this legislation; make journalists more independent. Let the editors be elected by the journalists, for instance, or let the journalists be appointed by independent panels. Take them away from media owners and operators who may be able to influence things creatively—proprietary rights. I think the case you make is absolutely, explicitly clear. However, you do not go the extra step. Every politician knows that there are journalists who indulge in boosterism just as every journalist knows that there are politicians who are crook. There is a minority of politicians and a minority of journalists who are not ethical, and greater independence for the media should surely be your campaign.

Mr Wolpe—Transparency and ethics are terribly important in the marketplace of ideas—shining spotlights so that you can have a back-and-forth that ultimately, hopefully, will lead to better products in terms of what people write and the quality of our publications.

Mr Beeby—We always do our utmost to see that the ethical standards are upheld.

Mr Wolpe—Because of the concern of the public, who wrote letters about travel and so forth, the *Sydney Morning Herald* doesn't do that anymore.

Senator MURRAY—Since we have dealt, and since you have dealt, so clearly with the direct inducement issue—it is unequivocal; you pay it, you must be licensed—do you have any

proposals for how public concern should be allayed with regard to boosterism and that sort of immoral steering of people towards an area because a journalist simply thinks it is in their boss's interest?

Mr Wolpe—The more voices that there are in this marketplace of ideas then the more the public can be informed to make its own judgment as to what is independent journalism, what may be boosters in journalism and what is quality journalism. Hopefully, we will have a reverse Gresham's law and the good will drive out the bad.

Ms Eisenberg—And there will be more funding for public broadcasters.

Mr Wolpe—This may be where our coalition breaks apart!

Ms Flynn—We are not asking you to give us something that does not currently exist. We are basically looking to maintain a status quo where there are provisions in certain circumstances—as Mr Rudd was just referring to. We would like to see the PS118 policy stance maintained and continued as is under the new regime. I think there is an awareness in all sections of the media of all the issues that we have been talking about. Having worked at Fairfax, I know that there is a clear division between church and state, and most organisations that I have worked in maintain those divisions. I know that it is easy to argue the contrary but, in practical terms, in all the media organisations in which I have worked, fierce editorial independence battles go on. I am sure that Mr Beeby and Mr Wolpe would both be able to cite numerous cases—

Mr Wolpe—We try to get favourable coverage of our businesses and we cannot do it!

Senator MURRAY—You must be careful not to protest too much because there are always examples on the other side. Let us keep right to the button on this. I agree with Senator Cooney that you should be arguing that you are not included in the bill, and that people who happen to be journalists who are also paid in this area should be licensed—as a consequence of them giving paid financial advice. My difficulty is where there is a material indirect inducement as to how they should be caught. My instinct is that journalistic standards should actually dictate that, but it is still a worry that there may be times when an indirect inducement results in financial advice and steerage being given.

Mr Wolpe—But again, even under the existing exemption and the ASIC rules, if there is a concern then it can be presented to ASIC, ASIC can look at it and new rules can be developed. The question for us is: will we have a presumption of an exemption in law that affords basic protection?

Senator MURRAY—I do not think you must use a presumption of exemption. I think you must use Senator Cooney's language: that you simply should not be in the law. How can you be free if you are in this law? How can you be independent if you are in the law?

Ms JULIE BISHOP—Is that a rhetorical question or are you waiting for an answer?

Senator MURRAY—I am actually asking the question because I think the law is clear. If you are paid money to give advice then you must be licensed, and you agree with that. That is

the end of that argument. Now the question is: what about everybody else in between? If you are a journalist you are not a financial adviser.

Ms JULIE BISHOP—Following from that, the nub of it comes down to a statutory exemption versus regulation.

Mr Wolpe—Yes.

Ms JULIE BISHOP—Obviously, regulation has final flexibility in terms of future development. Perhaps when the statutory exemption was dreamt up, back in 1970, there were not the scenarios of media companies with cross-shareholdings in financial advice companies—or whatever media organisations have cross-shareholdings in—nor of journalists moonlighting or doing other things, nor was there the issue of datacasting. Perhaps there were none of the sorts of issues that are on the horizon now. Isn't there some sense in the flexibility of putting this in the regulatory regime, rather than having statutory exemption?

Mr Wolpe—They coexist. You have a broad rule, again, or a general framework in the law, but you have full flexibility by the regulator. But we are comforted greatly by something in the statute that says, in general, again, that the media should be exempt from a licensing requirement. It is a terrific thing to have in the law.

Ms Eisenberg—Also, the concern about people not disclosing conflicts of interest or personal interests is quite a separate question from the issues that are dealt with in this legislation. It is a broader issue, and it is something that is dealt with in ethical codes and guidelines. It is a different matter.

Ms JULIE BISHOP—Maybe that is something that should be statutorily imposed somewhere.

Ms Eisenberg—But the issue is different from the new regulations that we are looking at now. I think we have to be careful not to confuse the two because it tends to cloud what this legislation is trying to achieve and what we are trying to achieve.

Ms JULIE BISHOP—Section 77(7) of Corporations Law, the media exemption, says:

Subsection (6) does not apply in relation to a newspaper or periodical, or transmissions, sound recordings, video recordings or data recordings, as the case may be, whose sole or principal purpose is to advise other persons about securities or to publish securities reports.

So, essentially, what the bill proposes is precisely that, but not in statutory form.

Ms Eisenberg—It does so in a much foggier prescription; in a way that is much harder to interpret.

Mr Wolpe—The bill is silent.

Ms Flynn—And it then reverses the onus.

Mr RUDD—It is the reversal of onus that is the first issue. The second is that this current operationalisation through the regulation is quite specific, and the test is principal and sole purpose.

Mr Wolpe—Which is why I responded on the question of—

Ms JULIE BISHOP—This was originally a reversal of the onus—

Mr RUDD—And from where it proceeded.

Ms JULIE BISHOP—Yes, and so we have had a reversal of the onus as a reversal of that. We do not want to go back.

Mr Wolpe—We do not want to go backwards.

Ms JULIE BISHOP—I understand that.

Ms Flynn—That is the sort of scope of how this is all going to be interpreted. In practical terms, flexibility also means that it grows and grows. The regulations grow and get interpreted by someone different, and they get bigger, bigger and bigger.

Ms JULIE BISHOP—I am trying to imagine this scenario with datacasting: there is the financial news at the end of the news, and then the datacasting kicks in and up pops the little banner, 'Do you want to buy some shares in BHP?' That is a fairly grey area.

Ms Eisenberg—There is another grey area. On page 42 of ASIC's policy paper there is an example of the potential for liability of Internet portal operators. Some of the functions they are talking about cross over into the sort of applications we are testing at the moment in terms of interactive television. They are applications through which people might ask for tailored information. They might want to know all about particular types of securities. They have put in the request or we have profiles of them and we are able to deliver a package of materials at their request. Once you actually do that act of tailoring, even though it is automatic and it might happen through an automated system, it seems to bring you in under the licensing system. Yet, you are not actually giving—

Ms JULIE BISHOP—You do not have a problem with that? You do have a problem with that?

Ms Eisenberg—I have a problem with that, because—

Ms JULIE BISHOP—Even though it is personalised?

Ms Eisenberg—But it is not really personalised in the sense of giving financial advice to someone in the way that a financial adviser would.

Ms JULIE BISHOP—But they will be relying on it.

Ms Eisenberg—But it is packaging up a piece of information. Someone might say, 'I am interested in knowing about mining companies,' so you might pull out all the data on mining companies and send it down the pipes to them.

Ms JULIE BISHOP—That is pretty generic.

Ms Eisenberg—There is nothing that involves financial expertise. But, using the example in this policy proposal paper, that would be something that would seem to be caught by the new rules, even though, as you said, it does not seem to be the sort of thing that should be. This is what we are getting at. The current test is very clear: you have sole and predominant purpose. So it is very obvious what that means and we can apply it. The new test involves a whole lot of layering of different issues and balancing of these factors. If you actually go through some of the examples in the policy paper, you will think, 'That is not caught by it,' and you will get to the bottom and ASIC's view is, 'Yes, it is.' You will find that your own view is different from some of the views that were expressed in that paper, which suggests to me that the rules are unclear in their application and that we have taken a step backwards in going to an unclear prescription from something which has been very easy to apply over the last 30 years and which has not caused any great confusion.

Ms JULIE BISHOP—Perhaps Bruce can answer this. Has there been any case law on section 77?

Mr Wolpe—No.

Ms JULIE BISHOP—Have there been judicial determinations on the sole and dominant purpose test?

Mr Wolpe—We have never been contacted to say that what we are doing is in violation of 77.

Ms JULIE BISHOP—You are not aware of any reported cases on it either?

Mr Wolpe—No.

Ms Eisenberg—In fact I should say we looked at Ford's loose-leaf service on company law, and in the entire text of that service there is no mention of 77, other than in the reproduction of the legislation.

Mr Wolpe—It is a perfect provision of law. There is no controversy under it—until today.

Ms JULIE BISHOP—Nobody has thought of a challenge to it. I am sure there is somebody out there wanting to challenge the information provider section of the Trade Practices Act. They just have not got the facts together yet.

Senator COONEY—How can you say you have freedom of the press if you have got to ask us for it?

Mr Wolpe—That is how we feel about it.

Senator COONEY—But that does not change, does it?

Mr RUDD—We mentioned before this question of the experiment. Mr Wolpe, you are obviously a person of some international experience—you are obviously a Canadian—

Ms JULIE BISHOP—This is very unkind.

Mr RUDD—Have you, as representatives of the media, actually looked at this question of any other international precedents in, say, the OECD?

Mr Wolpe—To our knowledge, there is no licensing in this area of financial journalists anywhere in the developed world—Europe, North America or any other democracy. There is none that we are aware of.

Mr RUDD—Finally, to conclude where I left off before, again on this letter from the minister, I make the comment that, upon rereading it, there was quite an important weasel word in this letter.

Ms JULIE BISHOP—Withdraw that!

Mr RUDD—There is. It says, 'It is not the government's intention'—first weasel word—'to change the practical effect'—

Ms JULIE BISHOP—What, 'government'?

Mr RUDD—No, 'intention'. That is always a weasel word—we all know that. It continues, '... to change the practical effect of licensing requirements in media organisations. Essentially'—second weasel word—'the same activities are required to be licensed as under the current regime.' I submit that, having looked at it and at the current operation of the current statutory exemption through the regulation in ASIC PS118, I cannot see how that practical effect is deliverable through the current drafting.

Mr Beeby—I have been advised that exemptions similar to the one that we are seeking apply now in Britain, the United States, Canada, New Zealand, Hong Kong and Singapore. There are plenty of precedents.

Mr RUDD—Singapore is not a bastion of press freedom.

Ms JULIE BISHOP—Nor Malaysia.

Senator COONEY—I do not know about Hong Kong and Singapore, but the others have a bill of rights. That is the point that we were raising before.

Mr Wolpe—We simply hope that, on a bipartisan basis, you can support a statutory provision.

Senator MURRAY—It is not bipartisan—it is—

Mr Wolpe—I am sorry—tripartisan. My humble apologies. If there could be a provision in the statute, we would sincerely appreciate its endorsement throughout the committee. That would be very helpful.

Ms JULIE BISHOP—And so say all of us.

CHAIRMAN—As there are no further questions, thank you for your attendance before the committee. That concludes our hearing for today. The committee stands adjourned until 9 a.m. tomorrow, when we will have a public hearing with the Australian Securities and Investments Commission in relation to our responsibility in overseeing ASIC. Then, at 12 noon, we will resume our hearing on the Financial Services Reform Bill.

Committee adjourned at 5.19 p.m.