COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Reference: Financial Services Reform Bill 2001

THURSDAY, 14 JUNE 2001

SYDNEY

BY AUTHORITY OF THE PARLIAMENT

INTERNET

The Proof and Official Hansard transcripts of Senate committee hearings, some House of Representatives committee hearings and some joint committee hearings are available on the Internet. Some House of Representatives committees and some joint committees make available only Official Hansard transcripts.

The Internet address is: **http://www.aph.gov.au/hansard**

To search the parliamentary database, go to: **http://search.aph.gov.au**

JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Thursday, 14 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 Chapman, Conroy, Cooney, Gibson and Murray and Mr Rudd

Terms of reference for the inquiry:

Financial Services Reform Bill 2001

WITNESSES

Committee met at 12.50 p.m.

CHAIRMAN—We now move to the resumption of the public hearing in relation to the Financial Services Reform Bill 2001 and I call the committee to order in that context. Today the committee conducts its third day of public hearings into the provisions of the Financial Services Reform Bill 2001 . The committee decided to inquire into and report on the provisions of the bill, which was introduced into the Commonwealth parliament on Thursday 5 April.

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 and consequently the committee resolved to receive submissions until 7 May, and indeed late submissions are 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 submissions to those who wish to obtain them.

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 evidence provided. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for the discharge of parliamentary functions without obstruction and fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before the Senate or any of its committees is treated as a breach of privilege. I also 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.

Senator CONROY—Before you move on to ASFA, in estimates, questions on notice that are returned to the committee are automatically public. I understand we have received a response to some questions I asked yesterday from ASIC. So I was just wondering—

CHAIRMAN—You have received a response?

Senator CONROY—I understand the committee has. Can I just check the status of answers taken on notice—if they got back to us?

CHAIRMAN—These were questions you asked yesterday of witnesses?

Senator CONROY—Yes, yesterday or last week.

CHAIRMAN—Last week?

Senator CONROY—It may have been to a different committee, then. I think it was Tuesday's committee—the superannuation committee.

CHAIRMAN—Nothing to do with this committee.

Senator CONROY—I have got ASIC three times in a week—I am a little confused.

CHAIRMAN—We will proceed.

ANDERSON, Dr Michaela, Director, Policy and Research, Association of Superannuation Funds of Australia

PRAGNELL, Mr Bradley John, Principal Policy Adviser, Association of Superannuation Funds of Australia

CHAIRMAN—I welcome our first witnesses today, who are representing the Association of Superannuation Funds of Australia. We have before us your two submissions, which we have numbered 16 and 16A. Are there any corrections or alterations you wish to make to the submissions?

Mr Pragnell—No.

CHAIRMAN—If not, do you have an opening statement you wish to make?

Dr Anderson—Yes, a reasonably brief one.

CHAIRMAN—If so, you may proceed and then we will move to questions.

Dr Anderson—Thank you for allowing us to appear here. ASFA generally supports the principles that underpin the Financial Services Reform Bill 2001, notably the establishment of a clear and consistent licensing and disclosure regime that will benefit consumers and industry alike.

ASFA is, however, unable to support the bill unconditionally as much of the operation of the bill remains unknown until regulations are made public and ASIC policy is finalised. The regulations are particularly important to superannuation funds as the government has indicated that disclosure for superannuation would be prescribed. Regulations and ASIC policy are also necessary to judge the full impact of the new licensing regime on superannuation fund trustees. The introduction of the Financial Sector Reform (Consequential Amendments) Bill 1998 recently has raised more questions than it has answered in relation to the transitional period for superannuation funds, particularly in relation to licensing.

ASFA recognises that the regulation of superannuation must have reference to the regulation of other financial products and services. However, as we have said, very often there are a range of characteristics of superannuation—most notably, that it is compulsory—that must be taken into account, because this means that the investor protection and confidence is greater than for most other financial products. Superannuation cannot and should not be simplistically equated with other managed investments.

The Australian community demands as much, if not more, faith in the security of superannuation as in the systemic security of the banking system. Reliance on disclosure and market forces alone would not provide the protection and assistance demanded by superannuation fund members. This is the basis for including superannuation funds under the prudential supervision of APRA, unlike other managed investments.

That said, we are concerned that the existing consumer protection and requirements for trustee behaviour should be recognised in all reform processes. The standards for the operation of funds and the behaviour of trustees are currently set through the Superannuation Industry (Supervision) Act and its regulations. To the extent that SI(S) Act requirements meet the new FSR regulatory requirements, the new arrangements should not result in or require a duplication of efforts and cost from the complying superannuation funds. We are not convinced that the bill or those who will administer it demonstrate a real understanding of the effect that comparable and simultaneously operating prudential regulation of superannuation funds will have on the operation of the financial sector's reform.

What confuses many is that the prudential measures available to APRA for superannuation are different from those used for prudentially regulating other entities which it supervises. In general, the measures are directed at policing the behaviour of trustees. The prudential and the consumer protection issues are not easily separated in superannuation. We have strong doubts about the logic of some of the distinctions being voiced about differences in regulating the trustees and regulating the fund—that is, in licensing for consumer protection purposes and regulating the funds compliance to standards.

The problems associated with making artificial distinctions become particularly relevant when we turn to the issue of licensing the providers of superannuation products. An example of somewhat erroneous thinking occurs at paragraph 4.41 of the explanatory memorandum in a discussion of those who will avail themselves of streamlined licensing. It says:

> This avenue is only available to those existing participants who are already subject to a consumer protection licensing regime, those who are currently not but are, for example, prudentially regulated or are not subject to any regulation at all must obtain a licence using the normal process.

Despite not being licensed by ASIC, non-public offer superannuation fund trustees are not operating in a legal vacuum. By electing to be regulated, all complying superannuation fund trustees have already had to demonstrate adherence with the onerous requirements set down in the Superannuation Industry (Supervision) Act 1993. Trustees are required to have both their financial statements and compliance with SIS audited on an annual basis and are subject to reviews by APRA. The consumer protection requirements of SIS include: disclosure requirements at fund entry, annually, on significant events, at exit and on request; and access to internal and external complaints mechanisms. Equal representation on trustee boards is a consumer protection measure and also, it is often argued, a prudential measure. SIS provisions which disqualify persons convicted of dishonest behaviour from being trustees or investment managers, the covenants at section 52 and standards relating to records, accounts and all other issues are as much consumer protection as about prudential regulation.

Having said that, ASFA does support the licensing of superannuation trustee providers but we have recommended that all SIS regulated complying non self-managed superannuation funds are treated the same as existing licensees for the purposes of the new regime and are able to obtain an Australian financial services licence to cover their existing activities through the making of a declaration.

The other area that has some concern to us, besides the licensing issue, is the current meaning of a retail or a wholesale client. We agree that anyone buying a superannuation product should be treated as a retail client and therefore have the benefit of consumer protection. But we are

very worried that people who receive, for example, a lump sum benefit from their superannuation may be considered wholesale clients and thus denied consumer protection if their lump sum is over $500,000 and they seek to reinvest that amount in a non-superannuation product. This is, I think, a very vulnerable group of people who have left the system with a large wad of money in their hands and then suddenly—because it is a large wad of money—are treated as if they are sophisticated investors. We recommend that consumer protection be extended to this group of consumers.

We have other concerns about when a person provides a financial services—and this is in particular in relation to the employer sponsor of funds. The bill expressly excludes work ordinarily done by clerks and cashiers as being considered a financial service. However we would support an enlargement of this express exclusion to include all routine administrative tasks with the object to remove particularly the employer sponsor.

SIS currently sets out requirements for superannuation fund trustees to maintain internal procedures for handling complaints and disputes from members and beneficiaries. It is not clear from the bill or the explanatory memorandum whether such arrangements would satisfy the general licence obligations and we recommend that the current internal dispute arrangements outlined under SIS be recognised within the proposed new system. Likewise with external complaints resolution, ASFA recommends that the Superannuation Complaints Tribunal maintain its recognised status as the external complaints resolutions scheme for superannuation licensees. If there are any jurisdictional problems identified, ASFA supports broadening the Superannuation Complaints Tribunal powers to remedy this rather than having licensees of superannuation going to two external complaints bodies.

ASFA has noted that within our current provisions there is in place a statutory compensation scheme for funds that have suffered loss as a result of fraudulent conduct or theft and we do support any requirement under section 912B for superannuation licensees to hold trustee liability insurance. It is at the moment a matter of best practice but ASFA would support making it a requirement.

On the final area of product disclosure, ASFA strongly believes that disclosure requirements for superannuation must be devised in a way that acknowledges the special nature of superannuation. In particular, any disclosure requirements must recognise that superannuation is compulsory and therefore many people who become superannuation fund members may be financially unsophisticated. We therefore have supported the setting down in regulation of detailed disclosure requirements. We would very much like to be involved in any discussion of what those regulations would be, as we have undergone quite a lot of consumer research. We have a lot to offer in developing those regulations. Thank you.

CHAIRMAN—Mr Pragnell, do you have anything to add?

Mr Pragnell—I am fine.

Senator COONEY—Would you get to the point where you say superannuation is so unique because of the fact that it is compulsory and it has got all these problems with trustees and so on so we ought to have a specific body that services it and takes into itself similar provisions to

what we are proposing for ASIC? Would you go that far or do you think the present scheme is good enough if we make the adjustments that you are talking about?

Dr Anderson—What we are saying is that we would like what is there already recognised in the licensing process. If in fact you want more protection then you come back. We are particularly concerned with duplication: what is prudential regulation and consumer regulation for us is a difficult boundary.

Senator COONEY—I was wondering whether you would not want it in one body so that it could do the whole thing.

Dr Anderson—We are suffering at the moment increasingly from fragmentation even within the pieces of legislation that apply to us. Managed investments are not prudentially supervised. We have been put in the position to be prudentially supervised by APRA and have our consumer parts, the disclosure and dispute resolution, under ASIC. We recognise that as an issue. In this bill ASIC tends to want to be a de facto prudential regulator of managed investments. We have issues that we already have prudential regulation through another body, so please do not duplicate it. That is our issue.

Mr Pragnell—Some of the issues come back in a sense that the model of managed investments is used quite a bit in terms of what FSR does but also ASIC's experience in regulating security dealers and investment advisers. In terms of gaining those licences through the process with ASIC you have to demonstrate you are a fit and proper person, that you have asset backing, performance bonds and so forth. Those are requirements that flow out of SIS already so, in a sense, by taking that model which, say, a security dealer would apply with, that would be applied on them in terms of the hoop they have to jump through. It is all in Corporations Law; it is all administered by ASIC.

The problem comes back to the fact that there are the two sets of legislative requirements that we have to deal with. In most instances the requirements in the SI(S) Act for superannuation funds are actually more demanding than those requirements in FSR. An example would be in section 920A of the FSR. You have to be considered a person of good fame and character. You are not considered a person of good fame and character if you have been convicted of serious fraud in the past 10 years. If you look at a similar obligation in the SI(S) Act—I believe it is section 120—when you are looking at who would be disqualified as a trustee, it is any person who has been convicted of any dishonest conduct at any time in their life. The person who commits serious fraud over a 10-year period is out under both regimes. But this is a real life example that has come up in superannuation: a person was convicted of stealing a watch 30 years ago in Turkey when they were a backpacker. Under the application of SIS they are excluded as they are considered a disqualified person.

You can argue the merits of whether or not they should or should not be, but the SI(S) obligations are actually tougher and more demanding. They capture more offences than would have been captured under the FSR regime. I think what we want recognised is that, for instance, in terms of applying that test, if you need the SI(S) test and if you are not a disqualified person, then you are also taken to be of good fame and character under FSR. So there are not two sets of check lists that you have to go down; we basically want people to have to deal with only one check list. Those are really the types of issues that we are looking at.

Dr Anderson—And we do support the higher standard there.

Mr Pragnell—Yes, definitely. That is what we want to ensure, that it does not get eroded in moving to FSR either, including the Superannuation Complaints Tribunal. The SCT is sort of lumped in with all these external complaints resolution schemes. The SCT has far broader powers in terms of being able to basically put itself in the shoes of the trustee and to produce its own decisions. The SCT does not have a monetary cap in terms of making whole determinations. There are lots of things that the SCT can do that one of these other external complaints resolution schemes cannot do. We think that is appropriate because of superannuation's special nature.

CHAIRMAN—Your submission makes a large number of recommendations. I think there are 35.

Mr Pragnell—That is only the tip of the iceberg. It could have been much longer.

CHAIRMAN—Could you highlight for us those recommendations that actually involve amendments to the legislation? A number of these recommendations are actually reinforcing support for particular pieces of legislation. Could you just highlight the ones where you are seeking amendments?

Dr Anderson—Recommendation 7, which is about retail and wholesale clients, is one that worries us a great deal. This is the area where you see some current affairs program with a whole lot of people who have been taken down; they are retired people and it comes up as a superannuation story that these people have been done out of their superannuation. When you get to the bottom of it, they are often the people who have left the superannuation system. They are getting out and they have not had the experience. They are not sophisticated investors. This is the first time they have ever had half a million in their hands.

CHAIRMAN—This is in relation to the general provisions of the bill as distinct from the superannuation provisions in terms of retail and wholesale. As I understand it, in your supplementary submission you deal with the fact that all superannuation clients are regarded as retail. But here you are talking about once they have taken their money out of superannuation to invest in something else.

Dr Anderson—Yes, once they have a lump sum. The other one is a different question. Brad, you might like to outline that one.

Mr Pragnell—The two issues are separate.

CHAIRMAN—I think I understand the other issue.

Dr Anderson—This is the wholesale question.

Mr Pragnell—With regard to the wholesale issue, if a large superannuation fund were investing in a pooled superannuation trust, it would be considered a retail client. That is a bit ridiculous if we are talking about a $2 billion superannuation fund investing in a PST.

CHAIRMAN—I understand that issue. I just wanted to clarify that you are dealing with the money after it has been superannuated, if you like.

Mr Pragnell—Yes.

CHAIRMAN—It has come out of the fund and it is being used for reinvestment.

Dr Anderson—It is an individual standing with the money in their hand. The other one is where the fund gets caught up in something that is inappropriate.

CHAIRMAN—So that is one that requires amendment. Is there anything else?

Mr Pragnell—We would like legislative clarification—recommendation 9, which is about clerks and cashiers. We just thought that use of the term 'clerks and cashiers' was potentially limiting, even though ASIC has indicated that they would interpret that to include all routine administrative tasks. We felt that it would be more appropriate if that were in legislation rather than in ASIC policy statements.

Dr Anderson—As I said, we are quite concerned where the employer sponsors employees who are actually doing some of the day-to-day work for the fund.

Mr Pragnell—I think you have to move quite a bit later on. Lots of it has to do with the implementation and creation of regulations and all that. Generally, in terms of legislative change, I think that those are the main ones that we dealt with. A lot of it comes down to how it is actually implemented, the regulations and the ASIC policy.

Senator MURRAY—Let us go back to regulators and where the ball has dropped between them. Are you aware that the Labor government in WA has called for a royal commission into the finance broker scandal there?

Mr Pragnell—Yes.

Senator MURRAY—Are you aware that there is an opinion, if you like, that the national regulators were absent, that things went on which they should have had their eye on and that the state regulators were useless? Hansard does not record a smile, but for your benefit I will record that you smiled.

Mr Pragnell—Thank you for that, Senator.

Senator CONROY—I have no idea how to describe that.

Senator MURRAY—We appreciate that.

Senator CONROY—It is called grimacing.

Senator MURRAY—The point of my question to you is really that it is quite plain that at the heart of the finance broker scandal is the usual mix of auditors and valuers who overstated and understated the financial situation—

Senator CONROY—Liberal party ministers—

Senator MURRAY—and of spivs and shonks who manipulated ordinary people's gullibility—

Senator CONROY—and brothers of premiers—

Senator MURRAY—and savings, et cetera. There is some murky stuff as well as political stuff there. I think one of the deficiencies which you failed to outline in your remarks is between state and federal regulation, particularly in this area. It is not so much apparent, for instance, with banking or financial institutions; it is not so much apparent with corporations because we have the national Corporations Law scheme. It is there with regard to financial investments and that sort of thing. Will you be considering this issue of regulatory dissonance—if you want to use that phrase—between federal and state bodies? Do you expect to be making a submission to the royal commission in WA, which may assist the development of public policy in this area?

Dr Anderson—In relation to superannuation, we would see the federal sphere as the regulator. I am not really clear as to how the state gets into the act.

Senator MURRAY—You were making general remarks, which have been made throughout this hearing—I know you have a specific super approach, and I know how that all works—but the fact is that this committee is having to deal with what are regarded as overlapping jurisdictions and, in some cases, conflicting issues between regulators. You specifically made the statement that you would want ASIC to keep away—these were not your exact words—

Dr Anderson—No.

Senator MURRAY—from areas which another regulator is busy with and has priority management of, which seems a perfectly reasonable statement. What I am saying to you is that as public policy makers—which is what parliamentarians are—we are faced with this problem between federal and state as well. The WA commission is the most recent of those expositions. What I am really seeking is the view of people like you on how regulators like you should interact and how they work best from an industry perspective. You might be able to provide a royal commission like that with some real life understanding of conflicts and how they have been resolved in that respect.

Dr Anderson—From our industry's perspective, we have been very concerned when states step in because it does muddy the waters, particularly when investment superannuation funds are covering a number of states. Our main experience with this problem of state-federal overlap has been with things like sex discrimination laws or where there are state laws and federal laws. That is where we have had the most experience of the difficulties of overlapping laws. In recent years, unlike in past years, I think we have probably been lucky in that our contending regulators have both at least been Commonwealth.

Senator MURRAY—My memory is that substantial numbers of Western Australian investors who were caught up in a finance broking scheme used superannuation money from private superannuation funds or money from a lump sum realisation. So I think you have a direct interest in this, frankly.

Dr Anderson—Once they have left, yes.

Senator MURRAY—I really believe that public policy is not assisted if people like you, who have a practical understanding from an industry's perspective, do not also assist those of us who are trying to resolve these issues by interacting with state bodies where they are looking at these things.

Senator CONROY—It was okay if you knew the premier's brother.

Senator MURRAY—We have that on record; you do not have to say it again.

Senator CONROY—I just wanted to make sure.

Mr Pragnell—We as an industry body are very much focused on trustees and the responsibilities placed on trustees, and how trustees are regulated by the main federal regulators: the ATO, ASIC and APRA. At times we do look at the issues of the underlying investments—which is what the instance is here—that superannuation funds invest in, but if we started looking at assets or investment specific issues we would need a staff larger than the ISC's probably to deal with that. There are issues not only regarding mortgage brokers; there are lots of issues regarding direct property holdings, related party transactions, et cetera, once you start to burrow down and look at how the states regulate the underlying investments. We do have an interest in that, but at the same time we are trying to deal with over 1,200 pages of documentation on the Financial Services Reform Bill. It has not ended. At the end of this process we are going to have probably close to 2,000 pages of FSR bill, explanatory memorandum and policy proposal papers from ASIC, and we have not even seen the regs yet.

Senator MURRAY—The entire Corporations Law was only 2,000 pages, recently released, I think.

Mr Pragnell—If you look at the size of what is coming through in FSR it is enormous. A lot of it does not apply to us.

Senator MURRAY—What does the Financial Services Reform Bill do other than say that people providing financial advice must be properly licensed, authorised and follow proper processes? That directly relates to investment practices in state situations under state—

Dr Anderson—I think a lot of that harks back to some of the issues that we already have now with APRA rather than with ASIC, who are interested in how trustees invest. We also have an interest there and that might take us into some of the areas that you are talking about. That takes us into an APRA area not FSR, so you can perhaps see some of the problems. As you were talking there I was thinking: yes, these are some of the problems that we are seeing coming out of some inappropriate investment in superannuation funds, where you want to look at the

underlying investments and how our prudential regulator gets in touch with that part of funds operation.

Senator CONROY—A number of other committees are looking at those issues with APRA.

Mr Pragnell—Yes. We have a very keen interest in EPAS and CNAL, for instance, because they do go directly to the issue of the trustees and the types of decisions made by trustees. That cuts more to the heart than the instance in Western Australia, where you are dealing with people who are self-managed fund trustees who are looking after their own money and who are relying on external advisers, be they solicitors in this case or a financial planner or an accountant or their next-door neighbour or whoever. That is obviously part of the problem, or part of the situation, but again we are very focused on the trustees. I think with something like EPAS, where obviously something broke down, or with CNAL, where something definitely broke down, you can point the finger back at what the trustees did or did not do, what the regulators did or did not do and what the auditors did or did not do. For us that is very important. That cuts more to the heart of the issues that we are interested in as an industry body and looking at ensuring that trustees are making the best decisions for members. If you are a self-managed fund trustee, you have taken it upon yourself that you are responsible to look after your own money. If you choose to rely on professional advice, maybe there should be protections for you, but it is different.

Senator MURRAY—I almost get the impression you are talking past each other. The investor is going to be protected or provided by a market system which has state regulators as well as federal regulators. What concerns me about the scheme before us is that all the evidence we have received and the draft are primarily focused on the federal regulatory system. Yet there have been screams of anguish in WA that have resulted in the royal commission into finance broker systems, which will undoubtedly come to a conclusion on further regulatory needs or ways in which such things can be avoided. I cannot foresee what they will come up with but they might continue with or enhance or change their inadequate regulatory scheme at present, and that directly relates to the issues of your members and the issues which this committee is dealing with.

What I am concerned with is that when you have made decisions and judgments about regulators you have not factored in the interrelationship with the states and whether there will be overlapping costs, whether there will be overlapping systems or whether there will be overlapping licensing regimes, et cetera, which could result from what is a very hot policy and political issue. WA has got one and there are a number of states in which it could be repeated. That is all; I cannot put it more clearly than that.

CHAIR—There being no further questions, I thank you for your appearance before the committee, the evidence you have given and the answers to our questions.

Proceedings suspended from 1.29 p.m. to 2.24 p.m..

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

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

CHAIR—I welcome the representatives from CPA Australia and the Institute of Chartered Accountants in Australia. We have before us your submission, No. 40. Are there any alterations or additions you wish to make to the submission?

Mr Reilly—No.

Ms Streeter—No.

CHAIR—If you wish to proceed with an opening statement you may do so, at the conclusion of which we will have some questions.

Mr Reilly—Thank you very much. The accounting bodies appreciate the opportunity of presenting evidence to your committee for the second time. We gave evidence in Melbourne at the end of April. We will be very brief. What we want to do today is to table two additional pieces of information. The first one is our submission to ASIC on its first series of draft policy papers. The second item is a legal opinion from Phillips Fox on the application of the Financial Services Reform Bill.

We are broadly supportive of the legislation of the bill. Our main concern is really clarification of just who has to be licensed. We spent some time giving evidence to the committee in April on that point. We have since had the opportunity of discussions with ASIC staff on the applicability of the licensing provisions, and that is really the reason that we wanted to table today our submission to ASIC. It is quite clear from our discussions with ASIC staff that ASIC itself also has some questions over just where the licensing provisions start and stop. A good example is in the ASIC draft policy papers. They refer to legal advisers or solicitors giving tax advice that is an interpretation of law, which is specifically exempted from the licensing provisions of the bill. Yet, at the same time, accountants will be giving essentially the same advice but from an accounting perspective. ASIC has raised the question as to whether that advice requires licensing of a particular accountant.

Our concern is that we believe that we can interpret the bill in such a way that licensing is only required when you are giving a specific financial product recommendation. If you go back to the Wallis inquiry in particular, upon which a lot of this legislation is based, from a consumer protection point of view that is exactly where the licensing provision should fit. However, the fact that the bill draws the term ‘financial advice’ and does not link it as clearly with financial product decision making raises the question as to whether financial advice that an accountant would traditionally give to their clients is in fact caught by those requirements. So we are seeking clarification, one, of just what the intent of the legislation is and then, two, depending on how that interpretation is taken, as to whether that is in fact appropriate in terms of the overall Wallis scheme. The Phillips Fox opinion arrived only this morning so we have just barely had a chance to look at that as well. I do draw your attention to the end of that advice

where it says that we have asked Phillips Fox to consider possible amendments to a wording of the bill, which would clarify the requirements of the legislation.

Our real concern is also that ASIC is placed in a very difficult position in that it is expected to be an efficient regulator. We do not believe that ASIC should also be taking the role of parliament in effectively interpreting and making legislative amendments by virtue of its policy papers. The difficulty of course is that ASIC's interpretation is simply ASIC's interpretation. We believe it really should be done at the parliamentary level.

We also note that your committee made a recommendation to the government where it talked about an amendment. I am quoting from the government's response to the Joint Statutory Committee's report dated 29 March 2001, where the committee recommendation was an amendment to address co-regulation and the position of professional bodies. In particular the committee recommended that the draft bill be amended so that it does not affect anyone whose involvement in financial services is incidental to their main activity. The government's response was that it did not accept the committee's recommendation, arguing by way of example that an accountant who provided advice incidentally where the consumer suffered a loss should also be covered. We agree with the government's example. However, we think there is a degree of confusion over the term 'incidental advice'. Our view is that, when anyone is giving a specific financial product recommendation, quite clearly they are required to be licensed under our existing Corporations Law requirements and the Financial Services Reform Bill 2001. However, what our members have traditionally done and will continue to do is provide a wide range of financial services up to a point, stopping short of actually giving financial advice on a specific financial product.

You may recall that the representative from the Financial Planning Association yesterday made the statement that, where you are providing specific financial product advice, you are required to be licensed. However, in terms of taxation or other issues, the licensed adviser would automatically go back to the accountant to get advice on the taxation implications. If our members were required to be licensed under this bill, we would envisage that you might be looking at an additional 20,000 members from our two accounting bodies, let alone other financial advisers who are operating in the industry, who will have to be licensed. There are significant administrative costs involved in doing that.

In our submission to ASIC we have estimated a cost of $10,000 per member to meet a licensing requirement. That $10,000 is a bit of a back of the envelope figure but, if you multiply that by 20,000 members, the costs that will ultimately be passed on to the consumer will create real problems, particularly for so-called retail purchasers of financial products, who will not be able to get accounting advice quite separate from whatever advice they are getting from a licensed financial planner. That is the concern that we have.

Ms Streeter—Keith has highlighted the main concern. I was going to raise one of our particular concerns, which we raised in our ASIC submission on the policy papers, and that is the 1995 cut-off date for training in interim policy statement 146. We understand the reasoning behind it and the broad-brush approach that they have taken. We are going to have the ridiculous situation, under the proposal, where someone who received their qualifications prior to 1995 and who has kept up their professional development hours over the years—say they did their training 10 years ago—will now be unlicensed according to IPS146, compared to a new

adviser who will be working underneath them, who has only just completed their training requirements. We believe the broad-brush approach is inappropriate, and there are recognition needs to be given to those members who did their training prior to 1995, provided that they have maintained ongoing training requirements.

Senator GIBSON—What are you recommending?

Ms Streeter—The recommendation is that, if someone completed their training prior to 1995 and they have maintained their professional membership and the PD hours that go along with that professional membership, they should not have to undergo additional training to meet IPS146.

CHAIRMAN—That has got to apply across the board, not just to accountants. You are talking about financial advisers and everyone.

Ms Streeter—That is right.

Mr Reilly—In fact it is a requirement at the moment that anyone who is licensed is required to maintain their expertise, both from an educational perspective and in terms of experience. I guess the requirement we are really looking for is to say that there should not be a specific cut-off date of 1995. Evidence that was given yesterday by a number of people argued the same point—that there is no magic in the date of 1995 and that you would expect a licensed financial adviser, a proper authority holder or a dealer to be continuing to meet those requirements.

CHAIRMAN—Those training standards are not actually in the legislation, are they? They are in IPS146. How are you suggesting we deal with that as part of the legislative process?

Ms Streeter—I suppose I just wanted to highlight that concern and the way that ASIC is interpreting the legislation. The legislation requires that adequate training be in place.

CHAIRMAN—Are you suggesting we deal with how you define adequate training in the legislation?

Mr Reilly—I think we would be happy if in your report to government you supported the fact that there should not be a particular time limit to make that statement. That would probably be enough to then have ASIC relook at that issue, if we had the support of this committee.

Senator CONROY—We appreciate your confidence in the powers of this committee. I wish we shared it.

CHAIRMAN—We have not been too successful.

Mr RUDD—What is the government's stated rationale in the 1995 cut-off?

Ms Streeter—The rationale I think is that new courses such as the diploma of financial planning were introduced at that point in time. But they are failing to recognise the ongoing—

Mr RUDD—To become chartered, post 1995 you had to do a special course in this, is that right?

Mr Reilly—To become licensed as a proper authority holder you had to do the new course. But what happened at that point in time was that those who had been licensed pre 1995 continued to be licensed on the basis that they were required to continue to meet their educational requirements, keeping up to date. So, back when the decision was made, there was grandfathering effectively on the basis that licensed advisers were keeping up to date. We would argue that exactly the same applies today, and that is our argument, which we have put to ASIC.

Mr RUDD—What is the box of magic in the new course?

Ms Streeter—In 1995?

Mr RUDD—Post 1995.

Ms Streeter—My understanding is that that is when the Financial Planning Association introduced their course.

Mr RUDD—And what is in it that is new?

Ms Streeter—I think it was formal training specifically in the area of financial planning, which had not existed.

Mr RUDD—So there was nothing before and this course replaced it?

Mr Reilly—No. Again I might have to take that one on notice, but my understanding was that there were educational requirements that had to be met. In 1995 there was a change in those requirements, but people who were licensed pre 1995 continued to act and were able to be continue to be licensed post 1995.

CHAIR—On the basis of their practical experience?

Mr Reilly—Yes, but we will get back to the committee on that one.

Mr RUDD—I think that would be useful because my experience is that bureaucrats rarely just invent things—there is an underlying rationale. As a former bureaucrat, I am saying this just to pre-empt what Senator Conroy is about to say about my background. Therefore we should know precisely what their rationale was and whether you think there is any merit in the post 1995 course content which actually means something in a real way to consumers of these products.

Mr Reilly—I guess it is interesting that, if we are going into this new regime, it will mean that from 1 October 2001 or 2002, whenever the legislation comes through, those people who are licensed pre 1995 up until now will have to get new qualifications. One could argue that they are already meeting the existing ASIC requirements for maintaining their competence, so we find it just a little bit difficult as to why—

Mr RUDD—The further spin on that may be if there was some rationale in the post 1995 box of knowledge, whereas it is plainly unrealistic for people to gear up with a new qualification by October this year but it may be entirely reasonable for them to gear up with a fresh qualification by another fixed point in the future. Hence my question about whether there is some genuine box of magic in the new course or whether it is what courses often are—things which look impressive externally but do not mean a lot internally.

Senator CONROY—I appreciate that you have only just got it this morning so you have not had a chance to fully digest it, but I am not sure it needs a lot of digesting; it is fairly straightforward. I am particularly interested in 4.6 where it makes the point that ASIC have attempted to subvert the federal government's legislation in terms of what constitutes financial product advice. This is an issue which I think Mr Rudd raised earlier about how parliament says one thing and then ASIC decides that they have got all this wonderful power so that they can waive legislation or, in this case, clearly contradict the intent of the parliament. Maybe I will happily raise with the chairman that probably, given the extent of the documentation that ASIC are writing and supplying, we may need ASIC to come in and give us a chance to question them about all the documents. I am sure a lot of people would be interested in watching.

The legal advice basically says that the FSR bill requires and intends to require an accountant making a recommendation or providing advice on a specific product to hold a financial services levy, but the ASIC paper produced recently:

... expresses the view that a statement or opinion or recommendation in relation to a "broad asset allocation decision" does not constitute financial product advice.

Are you concerned that you could be caught in a situation where ASIC is telling you one thing but the law says another?

Ms Streeter—Absolutely.

Mr Reilly—Yes, and I guess we have lived with that for some period of time. We believe that ASIC serves a very useful function in terms of regulation. In terms of ASIC providing interpretation, we have a degree more difficulty because we would argue that the law should be quite specific. The reality is that if we disagree with ASIC then we disagree with ASIC, and I do not think that is terribly helpful for the securities regime generally.

Senator CONROY—Phillips Fox seemed to be making it fairly clear. The bill says one thing but ASIC are actually saying the opposite. That looks to me as though ASIC are completely out of control.

Mr Reilly—I guess what ASIC are doing there is providing their interpretation and Phillips Fox are providing an alternative interpretation. On this particular one—4.6—the issue is broad asset allocation decisions. In fact, ASIC's policy to date has been that, if you are providing just a broad asset allocation, you are not providing a specific product recommendation; therefore a licence is not required. We would generally support that; however, where we are failing is that a broad allocation decision seems to be a lot closer to providing a degree of influence for financial product than perhaps giving factual taxation advice. If you are a lawyer, you are exempt; if you are an accountant, you may not be.

Senator COONEY—I would not have thought that was the distinction being made here.

Senator CONROY—I share your concern. I think that clearly a commonsense reading is the Phillips Fox reading in terms of the government's intention and the words in the proposed bill. I cannot say ASIC seem to be trying to rewrite history yet, because it is not history, but they are certainly trying to suggest an alternative position. Hopefully we will get a chance to call ASIC and have some discussion about these sorts of issues with them.

Senator COONEY—If you look at 2.2, it says:

Accountants provide the following services to their clients:

- Business development advice which includes strategic business planning, profit improvement programmes, marketing assistance, budgets and projections and management accounting.

That must come pretty close to giving advice as to where people ought to put their money. If that is a core service of accountants, then that is different from a core service that lawyers might give. I think there is—

Senator CONROY—Do you have any disclosure to make at this stage?

Senator COONEY—I get the impression that what you are saying is that, because there is one profession that is not going to be covered by this legislation, you should not be either. Is that what you are saying? Or are you saying that, if you look at the nature of accountancy, it should not attract this legislation?

Mr Reilly—I believe it is more of the second point. If you look at the current requirements, in shorthand terms you are required to be licensed where you are effectively making a securities product recommendation. In the preamble to the explanatory memorandum, the minister said that the current legislation was being extended to cover insurance, superannuation and futures. There was no statement that the legislation was also intended to sweep up a lot of broader financial advice which is not associated whatsoever with the securities recommendation.

In the first dot point in 2.2, the accountant would not be recommending that you purchase specific products but rather saying, 'This is part and parcel of the planning of your business. As a tax adviser, I would say, "Anticipate the future tax legislation; anticipate some succession planning."' That is the accounting advice that you want. If you want a licensed accountant to do all that, fine, but I think you need a separate regime to do that because the current financial planners who are licensed today would argue, as our representative from the Financial Planning Association did yesterday, that the current licensing scheme does not cover those sorts of competencies. So if we are looking at a broader licensing scheme—I am not saying that we agree with that; we would probably disagree with it—this is not the legislation to do it.

For instance, in tax advice you are required to be licensed if you charge a fee for preparing a tax return. You are not required to be licensed if you provide taxation advice; it is not the subject of this bill. If you are a registered company auditor—I will use this as a means of answering some audit issues, perhaps, if the chairman does not stop me—you are in fact registered by ASIC. An auditor will often be asked by the company to provide financial advice

if the company moves into a new activity. That has financial implications and yet all the auditor is doing there is effectively advising the company from an audit perspective. Does that cause any particular complications? There are financial implications for that. Does it fit within the company's current corporate governance from an audit perspective? You would be using your auditor to do that.

This legislation, defined broadly, could capture that but, defined narrowly, we would say it does not capture that. What we are looking for is a statement as to what the intent of the legislation is. That would be helpful, coming from this committee, and the issue of 'incidental advice' is probably, with hindsight, the wrong term.

Senator COONEY—I suppose the big thing is when the decision is made. If a person having been to the accountant then makes a decision to take on a particular investment, it could be said that they have been influenced by the accountant, whereas if they make a decision and then go to the accountant to get some advice as to its soundness that is a different thing altogether. I am wondering whether you are drawing the right distinctions in all of this. The broad sweep of the legislation is to protect people from bad advice. Instead of taking an action for negligence you can proceed along these lines, I suppose. It seems to me the profession of accountancy would say, 'We are giving advice after the decision is made to see whether or not it is a sound decision.' The distinction becomes so fine at times that it might be just as well to let them take out a licence.

Mr Reilly—If you are looking at the thrust behind Wallis, which is consumer protectionism amongst other things, that is the key element: the investor makes or loses money on the purchase of the financial product. Therefore, the licensing under our current regime requires people who are 'distributors' of financial products to be licensed—that makes a lot of sense—and that is where the licensing provisions apply. I do not see that extending that to anyone who gives broad financial advice is warranted because there does not seem to be much of a consumer protection basis there. It is actually at the point of purchasing the product that consumer protection is required.

Senator COONEY—The trouble is that, if you use the term 'broad financial advice' as a description so that you are not covered by the act, broad financial advice is a very hard thing to police, isn't it? You would need some other line of distinction to get out of the provisions of this legislation.

Ms Streeter—To act on that broad advice, you purchase a product and at that point in time you are meant to be getting advice or being warned that you should not make that decision without advice. By suggesting that you need advice at the general asset allocation stage and then again when the specific product is purchased, it sort of—

Senator COONEY—I follow what you are saying but—you said it yourself—it becomes very much a definitional thing and that is what you are complaining about. I am not sure that you have got near to the right definition.

Senator MURRAY—I want to address myself to the Cooney principle, as outlined yesterday, concerning journalists. Essentially, the Cooney principle said, 'If you are doing what you do as a journalist, you do not come into the ambit of the bill, unless you do what a journalist does not

do, which is give financial advice for a consideration—either directly, as in cash for comment, or indirectly.'

Would it not be far easier if the bill simply said that accountants are not financial advisers unless they receive a consideration for that financial advice? That is the journalistic approach. So an accountant who has an interest in putting people into a trust fund or a unit trust or an investment—a lot do—

Senator CONROY—I am not sure that applies.

Ms Streeter—Are you referring to—

Senator MURRAY—Let me just go through. An accountant that receives a commission for doing any of those things, to me, automatically falls in the bill. There is just no question about it. They have got to be licensed. We are talking about people who do their normal accounting duties and then are asked, either pre- or post-event, 'I have got a bit of extra money here. What do you think I should do with it?' That happens an awful lot with small business people and accountants, because they are their financial advisers. They trust them. They deal with them on a very regular basis. It is a trust based relationship. If that person is not getting any consideration, the payment is actually from the small business person. They pay them every time they visit them. It is $120 an hour, if they are lucky. I have got sympathy for the accountants who say that that is not financial advice, but is part of an overall accounting duty. Then you get into the definition as to when it crosses over and when the accountant has got to say, 'If you want to know if you must specifically place your money in such and such a super fund or investment or this or that, I have to advise you that under the law you must take primary advice.' If the accountant wants to go further than that, then they would need to be licensed.

Mr Reilly—I think that is a very good example and I broadly agree with your conclusion. What the accountant would do is that there would be a charge in terms of consulting advice, but it would be usually on a per hour basis. The accountant would say, 'There are a number of things you could do. Your business is overgeared, so it would seem to make sense to have a look at the borrowings within the business.' I would say that that is probably still traditional accounting advice that does not require a licensing mechanism.

On the other hand, the accountant could well say, 'You should build up your asset portfolio.' A broad allocation might be to say, 'You are operating within an Australian environment, perhaps in a rural community, so you want to lock yourself into that rural community's asset base. In terms of specifics, though, I would refer you to someone who is licensed—a licensed financial planner—who will give you a specific financial plan and make specific recommendations.' That person who is making the specific recommendations and who is then going to be remunerated and rewarded by charging a fee or commission should be licensed and is required to be licensed now.

The evidence we gave in April drew attention to the fact that often what will happen is that the consumer, the accountant's client, for want of a better term, will then bring that financial plan back for the accountant to look at. The accountant will at times say, 'That looks fine. However, do you realise that there are capital gains tax implications of going into that structure?' What we are arguing is that that type of financial advice is not a specific product

recommendation as such. It is simply factual information, and the situation is not a lot dissimilar to that of lawyers providing factual information based on the interpretation of the law.

Senator MURRAY—What I understood the 'Cooney generalist principle' to be is that only those who genuinely give advice and receive money for it should be licensed. The alternative, frankly, if the view is that all accountants give some advice of some kind, is to license the whole lot. Then you are into regulation, accreditation, standards, costs and all sorts of stuff, which surely is where we do not want to go. I just think the point Senator Cooney made yesterday was: leave off exemptions, talk about who should be licensed and who should not be and in what circumstances they need to be licensed.

Mr RUDD—If you are out there in suburban Australia, consuming the services of your neighbourhood accountant, there is a genuine problem in terms of the seamlessness of the service.

Senator MURRAY—In which case you would have to license them. That is the choice. I think we have to make that choice: all or some.

Mr RUDD—I think that is the direction in which it heads because the spectrum of services provided by accountants at the neighbourhood level is very broad. The point at which tax advisory lapses into financial services advisory is, I think, beyond clinical definition. When you apply the now established 'Cooney principle', that a financial services product is only deemed to have been transacted when it is paid for, the problem is that when you are paying a local neighbourhood accountant on an hourly basis—$150 an hour depending on the suburb, or $300 an hour down here—then the sub-itemisation of the account, as you know, will not simply be 'tax advisory', it will describe itself as 'accounting services'. I think there is a real problem. I have interrupted because it was relevant to your point but I have other questions to raise as well.

Mr Reilly—That is probably a Rudd amendment to the Cooney principle. Our members are very clear. We have very strict ethical requirements. The first one is: do not provide services that you are not competent to give. We are saying very clearly today, as we have said before, that our members are not making specific product recommendations. If they are, we agree they have to be licensed. To use the example of Senator Conroy's wide reading in the *Age*, in the *Money* supplement you do not see accountants saying, 'the top three picks'. If you did, I would argue they should be licensed. There is no doubt about that.

Senator CONROY—Do you think that journo should be licensed on that basis?

Mr Reilly—Well if our accountant is doing that in a newsletter going to his clients, then I would say, yes, they should be licensed because licensing does demonstrate that the particular person who has been licensed has met appropriate competencies along the way.

Senator MURRAY—They are receiving money for that newsletter, either directly or indirectly.

Mr Reilly—We would argue that it is quite clear, and the experience we have from our members is that it is quite clear, that once they get involved in making specific

recommendations, licensing applies. Back away a little bit from that, we do not see the merit in having a licensing regime in place

Senator CONROY—Can I ask the same question that you heard me ask the media representatives last night: are there any services that an accountant provides that would be deemed 'financial services' under the definition that you would prefer?

Mr Reilly—A number of our members have moved into the financial planning areas, particularly in rural and regional Australia. Rather than relying upon a financial planner who operates under a different code of ethics, some of our members are proper authority holders. Some of our members, a few, actually have their own dealers' licences. So that activity is clearly caught. Very simply, if you are making a specific product recommendation and it is intended to influence—and I think that is the thrust of this legislation—licensing is required now and should be required under the bill.

Senator CONROY—In the Phillips Fox legislation they are defining the core traditional services to clients, in the third dot point which says:

> Financial services advice including financial evaluation, financial planning, superannuation, estate planning and wills.

You would argue that even though Phillips Fox have given a technical description of 'financial services advice', that is not actually financial services advice in the way you are defining it.

Ms Streeter—Can I give you an example? In our submission, *Response to ASIC Policy Proposal Papers,* at the very back page, we have given an example of what you could call financial planning advice which we do not believe would need to be licensed. It is fairly complex but it does occur.

Someone is about to remarry. They have assets in their own name and business assets jointly with their ex-spouse. They have a family trust which includes children of a previous marriage and an ex-spouse as beneficiaries. They want advice from the accountant as to how to arrange their financial affairs after the new marriage to a person with no assets, a disabled child and an ex-spouse who is bankrupt.

Senator CONROY—So you would say that is not financial advice?

Ms Streeter—If they say I am not giving any advice in relation to any specific products, yes, but that is a situation that accountants would incur.

Senator CONROY—I am not arguing but you would argue that that is not financial advice that could 'induce' someone—the key words—because that is what the legislation is about. The legislation describes 'induce'.

Ms Streeter—They do not get down to product advice. They get down to structuring their investments: 'You should structure them in these ways'.

Senator CONROY—The legislation talks about inducing to purchase a security, and you would think that nothing that arose out of that would induce a purchase of a security, security having the broadest possible definition as per the bill?

Ms Streeter—Yes.

Mr Reilly—I guess at the end of the day what the accountant is doing is relying upon the knowledge of the client to be able to assist the client in restructuring. The next step is to actually start doing all those sorts of things and that is where the accountant would say you need to see someone who is licensed. The alternative would be that the sort of expertise that those who are currently licensed under the Corporations Law are able to give, and I think the answer from the Financial Planning Association yesterday is 'to go see your accountant'.

Senator CONROY—I asked the witness to draw the line, as you remember, and he has agreed to go away and try so I will be looking forward to seeing what he comes back with. When you describe some of your members who have become financial planners, I would be interested to know what it is they do that is different extra from what they did before they made that decision.

Mr Reilly—Essentially what they are doing is recommending some specific products to the client, so you send your client across to a financial planner to say, 'Okay, you are now going to go into equities. What equities do you want to go into? Do you want to do an index in terms of the all ordinaries? Do you want to go into mining? Do you want to go into dot coms—I think were mentioned this morning? Do you want to have a proportion of your assets in terms of overseas equities? What overseas equities do you want? Do you want to go and use a mortgage broker, for instance?'

Senator COONEY—What you really need is someone like Phillips Fox. What you really want is that this does not cover accountants at all unless they give specific—

Senator CONROY—Mr Reilly's preferred position.

Senator COONEY—Unless they give specific advice about specific products.

Mr Reilly—We are saying that accountants should be treated no differently from anyone else. If they are giving specific product advice they should quite rightly be licensed. They are required to be licensed now. And I guess the lawyers would probably argue the same thing. They do not really need a specific exemption that is built into the bill. We can see that there are dangers in providing specific let-outs and the government's response to the committee's report in fact makes that point.

Senator COONEY—But lawyers are in a much stronger position than you I think, because all they are doing is saying this is how the law works.

Senator CONROY—First speak to a lawyer.

Senator COONEY—Say, in the tax area, they say just how the law works, this is how a promise works and this is how a representation should work, whereas you will be in the position

where you say, 'You ought to put your money in particular proportions—some in properties, some in shares, and all this sort of stuff.' I think accountants are much closer to it than lawyers. That is where your definitional problem comes, because in fact as accountants you are up against it the whole time. The distinction has got to be defined fairly tightly I think.

Mr Reilly—We have also had support from the legal profession who, whilst they are happy to have the exemption for legal advice, are also saying they have clients who ask for some business type advice and the lawyers would argue that they are competent to give that, given their knowledge of the client. So they do not have that perfect out either.

Senator COONEY—No. But I am not trying to help the lawyers. In fact if you listen to what I am saying I am just trying to help you. The lawyers have got less reason to go into that area. If a lawyer gives advice about a specific investment, I think he or she should go, because what is he or she doing there, whereas with your profession you are getting pretty close there anyhow. If what Phillips Fox says that you do it is true, and I accept that it is, then you are getting pretty close to the problem the whole time. In other words, you are in a profession that is talking about investments, talking about where you should put your money and how your money can earn interest, and profit, and what have you—a lawyer should not be doing that. Any decent lawyer should not be doing that; but you should be. I think that is where your definitional problem is big, because you are so close to it, whereas a lawyer is not. A lawyer's position is closer to a doctor's position. A doctor does not have to give any advice at all.

Mr RUDD—Can I take up my esteemed senatorial colleague Senator Conroy's point from before about inducement, because that is a term alive in the legislation. Let us just say that we have an accountant who is being straight up and down about what they do. The accountant says, 'I am here, I am providing tax advice and here are your assets.' But he then merges into the grey zone of saying, 'In terms of some broad asset allocation, let me suggest to you—against the classic mix of equities, property and the rest—that I think you really need to go stronger on equities.' And here is Fred down the road; he is the financial services adviser down the road, with whom the accountant has a rolling professional relationship. 'If you want to get into the equities game then this guy down here, a mate—might be more than a mate—is the person to go and see.'

The reason I say that is because then this whole question of inducement becomes a very live concern indeed, because it is not just 'Well, as a piece of abstract logic if your asset allocation is 40:40:20 and it should be 30:30:40' it instead becomes one of saying, 'Well, you actually need to have a higher weighting in equities and my mate, with whom I have a relationship, is going to give that advice to you.' Now does that ever happen in your profession?

Mr Reilly—It certainly does. We have, in fact, issued benchmarking tools that compare different occupations in terms of profitability, asset mix, investment structure. There are any one of a number of those models out there that will actually say that a classic mix is—in terms of risk minimisation—to have a certain amount in equities, a certain amount in property and a certain amount in all sorts of other things.

Generally the evidence from our members is that they are very wary of giving general advice because of concerns over the exact issue that you raise there is an inducement to suddenly rush out and buy shares. So, I think, that is where the line in the sand is murky. Under 4.6, which we

have already drawn attention to, ASIC are actually saying 'a broad asset allocation decision'—and that is ASIC's current interpretation as well as their interpretation under the bill—does not require licensing. It is at the stage that it starts to get murky. Certainly at the next stage, where you actually go and make some specific decisions and you buy BHP shares or you buy whatever else you buy, clearly licensing should apply there. Consumer protection is needed. At the broad allocation area, it is a murkier area.

Senator COONEY—To be fair to ASIC, 4.6 is pretty clear, I would have thought.

Senator CONROY—It leaves ASIC with greater control.

Mr RUDD—The point I was making, also in the connection, is the possible connectedness between the provision of broad advice and the subsequent provision of narrow advice by a person professionally affiliated, and/or personally affiliated, and/or affiliated in a pecuniary sense, with the provider of the broad advice. That is where we enter into the ethical grey zone and there is the need for some level of consumer protection. That is my point. Acting as the complete devil's advocate, can I ask you: what is so obnoxious about being licensed anyway? What is the problem? At an operational level, there are a bunch of accountants out there; why is this such a huge bogey?

Mr Reilly—I guess the quick answer is that the securities regime is not designed to cover the sort of competencies that accountants are required to have in providing their services to the public at large. Therefore, if you are going to require accountants to be licensed under this legislation then the competencies that are required will be a completely different mix to those of someone who is giving specific investment decision advice.

Mr RUDD—Do you reckon they would fail the test?

Mr Reilly—No, they probably would not, but there are significant costs involved in doing that. At the moment there are some 30,000 who are licensed under the securities regime. We have identified at least 20,000 of our members in practice who would automatically be required to be licensed if you were going to go down that route. In addition there are also quite a number of professional advisers who are not members of the accounting bodies and who would be required to be licensed. I think the Institute of Chartered Accountants of New Zealand, and John Fielding in particular, have raised the concern there that those people would also be swept up in the requirements. So, at the end of the day, it is a cost-benefit exercise.

Mr RUDD—On the cost side, calculate the costs for me. You have got an accountant out there at the moment—a member of your association, not one who is not—and the directorate ultimately recommends that all of you have got to be licensed; the Cooney amendment gets up. Just give me a sense of what it would cost for a person to qualify to be licensed who currently is not.

Ms Streeter—To join a dealer group, to become a proper authority holder, will cost you anywhere between $5,000 and $10,000 per annum. On top of that, additional training and compliance requirements they would impose on you—

Senator COONEY—But you have got the training.

Mr Reilly—I do not think we do, actually, because you are looking at specific training involving investment products. That would be a completely different skill set, and a number of our members have determined that it is just not financially viable to take the next step and go into financial planning. They are quite happy to continue to refer their clients to licensed financial planners.

CHAIRMAN—And you cannot be licensed without being a proper authority holder?

Mr Reilly—Either a dealer or a proper authority holder.

Ms Streeter—And the dealer is a lot more expensive.

CHAIRMAN—You cannot just have the licence without actually buying the—

Mr Reilly—No. The reality at the moment, anyway, is that dealer groups are set up basically to sell and distribute products, so if you were going to license accountants you would have to look at something like a declared professional bodies proposal. That is quite different under the Financial Services Reform Bill 2001 from your proposal that you license accountants generally, because a dealer group would not want to take on our members who are simply providing financial advice and not actually distributing products. Therefore, the dealer group is not actually earning any money out of it. Anecdotally, a number of our members have actually become proper authority holders and then, effectively, have given it up because the dealer has said, 'You are not turning enough financial planning income through.' So that would be an issue there. There are a host of other regulatory mechanisms that you would have as well.

In our discussions with ASIC on the draft policy papers, ASIC has been concerned that, if it had to license lots of accountants, there would be significant costs to ASIC itself in setting up a regime to cover that. So there are costs the whole way through. At the end of the day, the cost-benefit test has to be met, and we have yet to see that as being an issue. If that were the case, you would probably say you no longer have to license tax agents, because if you are charging for preparing a tax return you are giving financial advice in one way shape or form; you probably would not have to license auditors either, I would suggest, Senator Murray—which might not be a bad thing.

Mr RUDD—I think, Mr Reilly, we are all familiar with arguments in extremis to advance a particular proposition, but if someone is a designated tax agent, plainly they do nothing other than tax. The burden of my remarks and questions on this is that in the accounting profession there is, I think, an overall professional drive towards an increasingly seamless service, to the extent that that is deliverable. Obviously, you have got problems in terms of separating audit out from tax and all that sort of stuff; we are familiar with that.

Across the other areas, in terms of what are the major profit drivers and profit generators for the profession, with respect to people who once simply dealt with tax, if you talk to accountants, they know that that is not actually where you make your big bucks. People are increasingly seeking to branch out. That is an observation on which I would appreciate your response. If that is the way in which the industry/profession is drifting, does that not create a broader rationale to cover the genus with a licensing regime, notwithstanding your cost compliance factors?

Mr Reilly—It is a fair comment to say that accountants have broadened their area of expertise and services from purely preparing a set of financial statements and doing a tax return. They are providing business advice. As you can see from attachment 1 in the submission we made to ASIC, there are a host of different things that accountants are doing today. That is part of the business service. However, the line in the sand is that, once you are actually providing a specific product, you are going into the securities area and recommending products; you are then jumping into a quite different field, with a different set of competencies and expertise.

The information from our members is that only a small number have actually made that jump across. Some of those who have done so have come back, because they have determined that it is not the line of business in which they wish to be involved. There are a whole host of different reasons; one is a licensing regime. Also, a client who has been put into One.Tel is a pretty unhappy client; a client who is advised to look at a broad allocation in terms of equities may not be that unhappy. At the very basic level there are things like that.

I would agree with your first observation that certainly the accounting services are very broad. They are professional services. But there is a distinction in that we have a licensing regime. Even if we did not have a requirement for a licensing regime, I would suggest, from what we are hearing from our members, that that is an area that most of them tend not to go into. They rely upon other experts along the way, in a similar way that you would use a lawyer to provide drafting of legal documents. It is a requirement of the law. Even if it were not, you would find that most accountants would not want to get involved in that area. They do not have the expertise or the competencies to do that.

Ms Streeter—Certainly, at CPA Australia, we are encouraging members to concentrate full time on accounting or financial planning because, as Keith said, they are jobs in themselves. It is very hard to combine them. We are trying to set up structures so that they can work very closely together, so that the client has a seamless delivery of service, but not necessarily all delivered by the one individual person.

Mr RUDD—My final comment is that a lot of the burden of your critique of what is before you in terms of legislation is the imprecision of the definitional question. That permeates much of the questioning and commentary so far here today. On the one hand, it is quite difficult to provide clarity of definition by way of the actual service delivered as opposed to the clarity that you seek, which is a clear definition almost by a professional group in terms of those who are inside or outside the regime. At the end of the day, it puts the debate into reverse emphasis.

With respect to approaching the provision of financial services advice from the perspective of an average consumer, if I am an average consumer—and there are many of them in my electorate—and I want some advice, having seen the ads on television from your profession, 'Get the advice of your professional accountant,' and taking up Senator Cooney's earlier observation, when people think 'accountant', they think of professional advice in terms of what to do with their money. That is the Clapham omnibus test which is alive in Lord Denning's view of the world. When they think of lawyers providing that sort of advice, it becomes much more of a marginal proposition. They think lawyers can probably tell you what is lawful or not rather than where you should actually dump your dough. To go to the third category that we have discussed in this exercise in the last couple of days, which is journalists, I think their view of

journalists is 'journalist shmirnalist' when it comes to actually getting ridgy-didge advice on where to dump your dough.

Those are generalisations but I am seeking to reflect the view of average consumers. At the high end of the food chain there is your mob, in the middle are lawyers and at the low end are journalists, in terms of the expectations of professional advice on what to do with your money. That is an underpinning assumption, I suppose, which I bring to bear in this discussion in terms of the extent of the licensing regime.

Mr Reilly—If I could just test that out: perhaps our advertising has been a mite too successful. Our practitioners are providing business advice as a general rule. The retail type of advice that they are providing tends to be tax returns but it is mainly at the business level—people who are running businesses. There are some high network individuals who require audits and they require detailed and complex taxation advice. They will get that from both accountants and lawyers. Our profession and those out in practice tend not to have a retail market as a general rule. To use your example of if you are looking to where you dump your money, I guess we find it interesting that you would automatically think of an accountant. The accountant would probably fairly quickly refer you through to a financial planner and also an investment adviser. Investment advice is probably a better term.

Mr RUDD—Average consumers do not know the difference. I would think they would start with an accountant as their first port of call.

Mr Reilly—Often that is because the accountant has a reputation, built over a period of time. But, in terms of actually helping that particular consumer to invest their dollars, that would not be what an accountant would do unless that accountant also happened to be licensed—that is the distinction.

Ms Streeter—We certainly want to encourage members who are licensed into the CPA and the accounting network and to set up those networks, so that accountants can refer from the non-licensed to the licensed and capitalise on this idea that you have to go and see an accountant to get your business advice.

Mr RUDD—Do they get a spotter's fee for doing that?

Ms Streeter—A new referral.

Mr Reilly—I am not too sure that we answered the remuneration level issue, which was raised earlier. Our members traditionally charge on a per hour basis. Once you start getting into the commission stage, I think you are moving much more closely into a retail type market, into a licensing type market. If you are referring a client to a financial planner and you are then on a commission basis if the client accepts whatever product the financial planner is recommending, I think you are moving a lot closer—again, we are talking about shades of grey and murk in the issue—to a situation where perhaps you are inducing.

Mr RUDD—How prevalent is the commission practice within the profession?

Ms Streeter—A lot of our members are scared to accept commissions.

Mr Reilly—I agree with Kathryn. Our members tend to charge on a time base. Once you charge on a commission basis you are locking yourself into recommending a product. There is an inducement there. The ASIC policy papers raise that. There is a degree of inconsistency in the draft, but they say in certain instances where you are receiving a commission for a referral you are not what is termed 'only a conduit' whereas if you are simply charging for your time and your expertise that sits outside.

Senator MURRAY—I am thinking about the pharmacy situation where the loan is provided by the producer. You do not have the unit trust managers funding loans for accountants, do you?

Mr Reilly—No. That is the soft dollar area; that tends to be more in terms of product distribution because that is where the product design and people who—

Senator MURRAY—I make that point half in jest. You also have to look at indirect inducements, and that is exactly what is happening in pharmacies. A pharmacist who is getting a cheap mortgage from a manufacturer of pharmaceuticals is without doubt bound to that person.

Senator GIBSON—I think you were here yesterday listening to the media reps, Keith. When the journalists have a recommendation by X, Y and Z printed in the newspaper, from your perspective would you see that they require to be licensed?

Mr Reilly—I would have to give you a personal opinion because it is not something that our membership has considered. They are actually providing a specific recommendation so, under my test, I would argue they should be licensed. However, I recognise that they are providing general advice in the media generally.

Senator GIBSON—They are not getting paid.

Mr Reilly—I was comfortable with the position that they were putting last night if, at the end of the day, they are not getting renumerated on a commission basis.

Senator COONEY—Mr Rudd was talking in terms of industry and profession. Have you ever thought of running the argument that if accountants generally had to be licensed it would change the culture of the profession? I always presumed that accountants in your organisation said that they had a task which, in honour almost, they had to perform, that this was a high duty that they had to perform; whereas if you are licensed, what you are doing is ticking off whether you have obeyed each of these tests that licensees might have to comply with. So you are looking at whether or not you are staying within the law rather than looking at whether or not you are performing a service of note for the community. Have you thought about that?

Mr Reilly—In the past there has been an argument to say the term 'accountant' should be a prescribed term in the same way that a 'lawyer' or a 'solicitor' is a prescribed term. Courts have not accepted that and I guess in the age of reducing barriers to entry it is a proposition that probably is not that sustainable. We advertise, perhaps a bit too successfully at times, that a chartered accountant or a CPA is a business adviser and someone who is able to give you professional advice, having regard to all of the ethical requirements that you would expect from an accountant, one of the key ones being independence. Therefore we have created our own licensing scheme and the costs involved in being a member of either CPA Australia or the

Institute of Chartered Accountants in Australia, with a practising certificate, are in the order of $800 or $1000 per annum, with additional requirements for meeting education and things like that. So we have, of sorts, set up our own licensing scheme to date, but it is a self-regulatory type scheme. The proposition that Mr Rudd put is one that we could look at but if you are going to go down that route, and I am not trying necessarily to induce you to do that—

Mr RUDD—Or verbal me.

Mr Reilly—or verbal you—keep it quite separate from the Financial Services Reform Bill 2001, which is looking at particular securities products. That is not the business that we tend to be in.

Senator COONEY—I think it is a very interesting point you make: that the barriers to entry to the various professions/industries have got to be lowered, if not taken away, to allow competition flow. Having got to that point we are now going into a whole series of licensing to get to the same result. It is just a very interesting development.

Mr Reilly—Senator Cooney, you could be, and call yourself, an accountant if you wanted to. If you were going to charge to prepare a tax return you would have to be licensed and registered. If you wanted to audit companies you would have to be registered, but if you wanted to provide very sophisticated financial advice, very sophisticated taxation advice, there is no licensing requirement. However, if you are going to recommend specific products to your clients as securities, then you are required to be licensed at the moment. The field is very specialised in particular areas.

CHAIRMAN—Thanks to both of you for your appearance before the committee. What we have gained from the discussion has been very useful for our deliberations.

[3.29 p.m.]

HARDAKER, Mr Ron, Executive Director, Australian Finance Conference

THORPE, Mr David, Associate Director, Australian Finance Conference

CHAIRMAN—I welcome the representatives of the Australian Finance Conference. We have before us your submissions 11 and 11A. Are there any amendments you wish to make to the submission?

Mr Hardaker—No amendments.

CHAIRMAN—If you wish to make an opening statement you may proceed and then we will move to questions.

Mr Hardaker—Briefly, the Australian Finance Conference was, when I joined it in 1973, the National Finance Houses Association. Of the 18 then members there are only two left. We have a range of 45-odd current members in their capacity as financiers that, one way or the other, includes banks, building societies, manufacturing concerns, motoring organisations and traditional finance houses. We have come to the financial services reform series of bills from that perspective. Early in the piece we were concerned that lending products were being included in the ambit of this, which we thought was inappropriate. We had concerns about how the regime would operate in conjunction with the prospectus provisions of the Corporations Law, which was the subject of one of the submissions to you. That has been clarified and we see no reason to raise those issues with you again.

The balance of our interests in the legislation has to do with the point that policy development has reached regarding term deposits with financial institutions: firstly our concern that deposits are in in the first place, and secondly at the two year cut-off point. To go through the arguments in the submission I hand over to David Thorpe, who is our associate director with responsibilities in that area.

Mr Thorpe—Certainly we appreciate the opportunity to speak to you. The full impact of the bill is still unfolding. That includes the transitional provisions, the ASIC policy statements, and regulations yet to come. Our members are busy looking at that, and we have been consulting with them as the information unfolds. We certainly welcome the refocusing of the policy towards those financial products with greater potential for risk. The bill, as we know, provides some concessions for basic deposit products and related non-cash payments, and this reduces the cost and operational impacts of the earlier regulatory approaches. However, the bill will continue to create costs and problems for authorised deposit-taking institutions—which I will call ADIs—particularly in the area relating to the deposit products; and it will continue putting stress particularly on the resources of agencies in regional areas. We strongly believe that deposit products should not be covered at all. It is an area which is well understood, with no market failure, and regulation is not justified.

The four main concessions—I will mention them because I want to highlight the fact that there are a lot of areas that are not concessional—that exist at the moment are: firstly: employees of authorised agents providing services in relation to basic deposit products need not be authorised; secondly, a financial services guide need not be given for dealing in a product, but an oral statement has to be made in relation to name, contact, dispute resolution; thirdly, a statement of advice is not required but certainly information must be given in relation to remuneration commissions, interests or relationships; fourthly, a product disclosure statement still has to be given but may be given after the product is issued.

What are the problems with the proposed policy in the bill? Certainly, as I mentioned, the concessions are a step in the right direction. They are a compromise, and we understand that. I draw your attention to two things. There is no clear reason why the line should be drawn at deposits with a term of two years or less. That does create problems. The proposed limited concession for deposits up to two years will cover a substantial portion of our deposits, so we can understand why the compromise has occurred. It does cover a large range of deposits, particularly at this time where there are low interest rates. However, it is an arbitrary and unnecessary line at two years, and ADIs will be discouraged from offering term deposits beyond that two-year period.

This creates a market distortion and there will be more of a market distortion when interest rates start to increase—as we imagine they will at some stage—and there is an increasing consumer demand for long-term fixed deposits. This will cause confusion amongst customers. You can imagine them going into a branch or agency and saying to a cashier, 'I've got some money. I'm interested in a term deposit. What have you got?' and the response being, 'Well, Sir'—or Madam—'we have these term deposits. They go up to two years and these are the interest rates.' The brochure would also show interest rates that went beyond two years. The customer would say, 'Well, I don't need the money for three years, so I'll take the three-year term deposit.' The response would be, 'I'm sorry, Sir'—or Madam—'I can't sell that to you. I'll have to send you to someone else.' The customer would ask, 'What do you mean? What is the difference?' The cashier would say, 'Well, one is three years and one is two years.' The customer would ask, 'Is there any other difference?' and the response would be, 'No, none whatsoever.' I will come back to that as you wish.

Also, there are still unnecessary prescriptions for even the basic deposit products for licensees and authorised representatives just to open and operate accounts. Putting advice aside at this stage, we are just in the dealing. The product disclosure statements still have to be given. Training still has to be given to develop and maintain competency provisions for all representatives, including employees of authorised agents, and clerks and cashiers. They will have to be shown to be competent. Licensees will have to authorise representatives—the pharmacies and newsagencies in the bush. There has to be advice to ASIC. They have to provide adequate supervision of those representatives. These are just one-liners, but there is a lot behind them.

Policy proposal paper No.2 deals with organisational capacities and the minimum requirements for representatives, which is just an interpretation of what is in the legislation, as we know. It states:

We consider that a licensee should implement and maintain procedures for monitoring, supervising and training representatives that:

(a) are documented and set out a clear reporting and supervisory structure for all its representatives;

Note: These procedures are part of the licensee's compliance measures and should be included in its overall compliance manual and/or plan.

(b) provide for material involvement of appropriately skilled and knowledgeable senior technical officers to supervise the activities of its representatives;

(c) ensure there is a system in place to supervise the activities of representatives. This system should identify compliance failures, and patterns of compliance failures;

(d) ensure that compliance failures by its representatives will be appropriately reported, both internally and (if necessary) to ASIC;

(e) provide for appropriate action to be taken to correct compliance failures by its representatives and to prevent further such breaches;

(f) provide for appropriate disciplinary action to be taken in response to compliance failures by representatives;

(g) determine the appropriate knowledge and skills requirements that its representatives require to perform their tasks and functions competently; and

(h) provide for the continuous training of its representatives.

ASIC proposes to use conditions on the licence to support minimum requirements for monitoring, supervising and training representatives under licensee obligation. There is a lot for representatives to understand and go through even in the basic banking deposit products. The concerns outlined in chapter 4 of the committee's report in August 2000 have not been solved. There will still be a rigorous staff training and disclosure regime, even though the risk is negligible.

In the area of advice, which we have spent a bit of time hearing today, there may be additional problems. The focus is not just on this but there may be additional problems in relation to advice. Cashiers should not be thought of as mere conduits. Cashiers do want to help customers. The bill may be cutting them off by limiting their role. The cashiers, of course under instruction, will be very wary about giving any advice or recommending or even referring, which may be taken as advice if they give an opinion or recommendation. I draw your attention to PPP6-B10, which states:

However, such a referral *may* involve the provision of financial product advice ... if the referral is made to a licensee who deals in or advises on a narrow range of financial products—

which a representative would be doing for their financial institution, their ADI—

and if the referring party receives a benefit dependent on the consumer's decision.

That could be, for instance, even a transaction fee that an agent in the bush would get for every transaction or account opened. Over the page the note says:

We do not consider that a referring party who receives benefits dependent on consumers' decisions to buy, sell or hold financial products would be likely to fall within the exemption for the actions of a clerk or cashier ...

In other words even a cashier or a clerk referring a person to head office, or wherever, may be caught. We note that the clerks and cashiers exemption is provided to avoid doubt only. So really it is not a clerks and cashiers exemption; it is just a clarification of the mere conduit prospect. Just looking at advice again, this may mean more rigorous training, possibly equivalent to diploma level for other than basic products and certificate level for basic deposit products. Interim Policy Statement No. 146, in relation to representatives—again this is referring to an agent in the bush, amongst others—says:

> We believe that licensees and principles can demonstrate that they have met their responsibilities by making sure that their representatives:
>
> (a) receive education and training that meets ASIC's requirements...
>
> (b) are trained at an educational level that is appropriate for their activities...
>
> (c) have been individually assessed or trained in programs that have been accredited by an ASIC authorised assessor....
>
> (d) undertake continuing training to maintain and update the knowledge and skills needed to carry out their duties.

Continuing on from that, if they are deemed to be an adviser—I am not quite sure, but there are a lot of examples in there—one can imagine that if a cashier at the front counter had a person come in and say, 'I have got this money here. I will not need it for a couple of years, where will I put it?' the cashier could say, 'Well, let's have a look. If you do not need it for a couple of years, here are the interest rates. For two years here is the interest rate. That is a good interest rate and I would recommend that that is probably the one you are looking for.' This is a recommendation—caught out giving advice. That seems pretty clear. If they use those words, they are giving advice. They have to be very careful about which words they use in order to make sure that they are not providing advice. That means that they are probably going to act very conservatively in providing advice to the little old ladies on the other side or whoever.

Senator MURRAY—So you get Clayton's advice?

Mr Thorpe—Not even that, I suspect. Basically, to be a mere conduit and to provide factual information you are not going to have to be very helpful; in fact, you are not going to be very helpful at all. So we are actually withdrawing services. These problems are compounded in respect of agencies, particularly those utilised by ADIs in regional areas. Firstly, employees of authorised representatives providing basic deposit products will not have to be authorised by licensees, but all other requirements will increase costs for the licensee and the representative. It will be harder to find agents, particularly remembering that it is usually only a small part of their business. The representative out in the bush is going to say, 'I have to do what to be your agent? For how much? I am running a newsagency; I am running a pharmacy.' Certainly, for those agents who do stay on their remuneration must increase.

Secondly, for financial services other than basic deposit products, only authorised representatives who are bodies corporate are able to authorise individuals to provide the financial services, if the licensee consents. A lot of agencies out there—newsagencies and pharmacies—are not bodies corporate, which means that the licensee is going to have to take direct responsibility for the staff of those agencies and directly authorise them and be responsible for them, not the newsagent or the chemist themselves. This means that ADIs must

directly authorise employees of authorised representatives or agents who are not bodies corporate if they provide term deposits for terms greater than two years, except if their conduct is only in the course of carrying on the duties of clerks or cashiers. I have already shown that that is not really a big exemption.

What does all this mean? It is going to reduce the deposit choices available to customers, particularly in regional areas. These kinds of stringent requirements are a discouragement to using agencies and are still likely to result in the closure of some agencies and a reduction in the likelihood of other agencies opening in the more peripheral areas where viability of the financial services is marginal or even negative.

There is no way in the world that the bill is going to increase the number of agencies in marginal areas and it is not going to improve the information or service given to customers. We believe it will reduce the service in relation to deposit products. This is making it unnecessarily difficult for regional Australia in particular. The frustrating part of the bill is that it does not add any value for customers. There is already satisfaction out there with the current arrangements in relation to deposits, accounts and non-cash payment facilities. There is no known significant market failure.

In summary, the case for an exemption of deposit products is outlined in the submission that I gave you, particularly on page 3, in the list of reasons why we do not believe it is appropriate. We support the general policy of the committee's recommendations in its report on the draft Financial Services Reform Bill in August 2000 that all simple deposit products and associated payment facilities should be excluded from the definition of financial products. The proposed requirements may be applicable to certain investment products, life insurance and superannuation, which are more complex in nature and are possibly subject to market fluctuations. As we know, there is a regime of regulations and the like that already exists and this streamlines those, so we can understand why life insurance and superannuation people are very keen to have the provisions in the bill. This is not the case with products with ADIs. They are well understood by the public and are capital guaranteed. Similarly, non-cash payment facilities are well known and understood.

In relation to the market failure aspect, the financial service inquiry, or Wallis report, stated on page 15:

> Regulation is necessary only to the extent that markets may fail and then only where it can be demonstrated that benefits of intervention outweigh its costs.

This principle is also outlined in *A Guide to Regulation*, second edition 1998, prepared by the Office of Regulation Review, a Commonwealth body, and was endorsed by the Commonwealth government. Compliance with the outlined procedures and processes is mandatory for all government departments, agencies, statutory authorities and boards making, reviewing and reforming regulations. In particular in relation to deposit products there has not been a compelling case put forward as to, firstly, what market failure exists and, secondly, how the benefits of the Financial Services Reform Bill exceed the costs in relation to deposit products.

Wallis states that consumer protection in the financial system is justified on two grounds: where complexity of financial products, one, increases the probability that consumers will be

misled and, two, increases the probability of misunderstanding and dispute. This is not the case with deposit products. Wallis, only in one area that I can find, hints at a possible market failure in deposits, and that was a survey presented by CUSCAL, the credit union services corporation, that some consumers considered bank deposits to be more liquid than managed investment products. In fact the survey also quoted a consumer stating a view expressed by many:

> Term deposits are easy to understand. I know I am going to get my 3.5% with the CBA and that in two years time it is going to be there. Other investments such as shares I don't know much about.

Wallis, in his report on page 661, showed that direct regulatory costs relative to assets were greater in Australia than the US, Canada, New Zealand, France and the UK. In compliance costs Australia was behind the US but ahead of the rest. Government and industry are trying to be internationally competitive, to be a regional financial centre and to encourage new entrants. Why apply regulatory and compliance costs and market distortions where they are not necessary and are, in fact, counterproductive? The recommendation is that all simple deposit products and related non-cash payment systems be excluded from the scope of the Financial Services Reform Bill.

CHAIRMAN—As you know, the committee dealt with this issue at some length in our consideration of the draft exposure bill and, as you have referred to, we recommended to solve this problem that you have highlighted by an amendment to the definition of a financial product. The minister came back with this bill and said he had fixed the problem, although he had not dealt with it via the definition of financial product but had dealt with it through the definition of financial advice. What you are saying is that that has not fixed the problem, that you really have to deal with the definition of product rather than the financial advice to fix the problem that you have highlighted.

Mr Thorpe—That is correct. It is certainly a step in the right direction that some particular compliance costs have been reduced or cut out. But there is still a lot there in relation to compliance, even in respect of dealing, let alone questions about advice.

Senator GIBSON—Have you had a look at the definition of 'basic deposit product' in the bill?

Mr Thorpe—Yes.

Senator GIBSON—Have you taken legal advice about any possible changes to that that you want to tell us about? You have made a firm recommendation about it, excluding all deposit products. In relation to the definition, which starts on page 5 and runs over to page 6 of the bill, in your evidence before you were suggesting that the two-year thing is a bit of a nonsense. Are you really suggesting dropping out that clause C? Have you given thought to or taken advice about how best to achieve the end that you have recommended to us?

Mr Hardaker—No, but we can.

Senator GIBSON—That would be useful.

Senator COONEY—You gave me the example that a newsagent could not tell somebody what the interest rates were going to be if it was for three or four years rather than for one or two years. I doubt that the definition covers that—you are allowed to give information to say what interest rate I will get if it is there for four years. That is hardly giving financial advice within the meaning of this legislation. It is just interesting that you used that example.

Mr Thorpe—I totally agree with you. A clerk or cashier can provide details of what the interest rates are for the whole range of term deposits. But, if it is a term deposit beyond two years, the clerk or cashier cannot sell the product to that person unless that clerk or cashier is qualified to deal with ordinary financial products, not the basic financial products. A front counter staff member can sell deposit products for terms of up to two years. But for anyone going beyond that two years you actually have to go and talk to a person within the organisation who is more competent, more trained and more qualified.

Senator COONEY—Couldn't your submission be seen as exemption creep? We pointed out to you that there is this difficulty about recommendations, so the government in effect gives you two years, and you say, 'That is not enough—if you have given us two years, why shouldn't you give us four? If you have given us four, why shouldn't you give us eight? If you let them give advice about that, why shouldn't you let them give advice about everything else?' I just see a little bit of that in it. I am sure that you did not intend it, but that is what I see. So instead of David Thorpe coming along three or four years from now, somebody else will come along and say, 'You allowed this; this is stupid,' and away you go. You will have drawn the line somewhere, as somebody said.

Mr Hardaker—Our official position was that the line should not have been drawn.

Senator COONEY—Exactly, that is what you are doing. You are saying, 'It should not have been drawn there. We have this concession, now we are going to keep getting concessions until we get what we originally wanted.' I think that is the problem with the argument. I want to hear what you say about that.

Mr Thorpe—I can understand the point of view and, as Mr Hardaker mentioned, in our initial submission to the committee we did say that they should all be out. So it is not as though we are saying, 'Give us two years, and then four.' We did originally say that they should all be out, so we are not trying to sneak up on you. The second point is: the reason that I highlight that the line is incorrect is that it does create distortions. As Mr Hardaker said, it is not really sensible to put a line anywhere, or so far out that it really does not matter. If you took it out to five or six years then it would probably cover everything.

But that is only one of the two points—that is, that a line creates distortions. The main point is that, no matter where you put the line, because there are only limited exemptions, there is still a big cost out there for branches as well as agencies that is going to hit particularly those marginal branches or marginal agencies, because it does involve more cost, more compliance training, et cetera.

Senator COONEY—Can I just get off financial services and on to medical services, and then I will come back to financial. You tend to get a good quality but a lesser quality of medical services in the bush because your top surgeons are not going to go there, or else you are going

to have a top general surgeon going there. You then say, 'That's just one of the results of living in the bush.' I think you used this argument, and I am just putting it forward for you to correct. What you are saying is, 'We can't really give you top services in the bush. We're going to, nevertheless, provide services through the pharmacies, shops, newsagencies and things like that and that's better than nothing'—which is true. You then go on and say, 'You're not going to be able to get the sort of advice that you do in the city about financial investments and what have you. We'll give you this, but it's too expensive for us to licence all these people. Because they are less able to give advice, we say we should not have to licence them because they are not going to give the sort of advice that you would be able to get in the city.' Can you follow that? You are sort of penalising the country people for the fact that they are out there.

Mr Thorpe—I think that is only partly true because the training is very similar for the chemist and his or her staff to what it is for branch staff in many respects, but it is a narrower range of products. Yes, it is a chemist because it cannot justify setting up a whole branch out there, so that is the element of truth in what you are saying. There is a more limited range of services. The problems that I have identified I suppose I highlighted because it is at the frontier in a double respect. The same problems exist for branch staff as well. You could go into the Martin Place branch of the Commonwealth Bank and still have the same problem of saying, 'I want to buy a three-year term deposit,' and then be told, 'I'm sorry, I'll have to put you on to somebody who is more competent than me to do that.' So the same problems exist within—

Mr Hardaker—Except the locum might be there in Ipswich or wherever, as distinct from Martin Place.

Senator MURRAY—Including your industry, from your evidence it appears that you think this law is attacking a non-existent problem; it just should not even cover you.

Mr Hardaker—It was the semantics of financial services—those two words.

Mr Thorpe—Yes, that is I suppose the base point.

Senator MURRAY—Is there any case history of failures? Is there a market failure to be addressed here?

Mr Thorpe—No. Our argument is that there is no market failure in the area of deposit products. They are simple, long-standing, well understood products. I do not even consider them necessarily comparable to shares and the like, but they are well understood so there is no market failure. From my reading of the Wallis inquiry, I could not identify areas of market failure. It was all about uniformity rather than market failure.

Senator MURRAY—Is there any sign that the most unsophisticated investor fails to understand five per cent interest rate return with quarterly payments into their account from a term deposit?

Mr Thorpe—I am not aware of any surveys or studies that have shown any market failure in that area. If Wallis is unable to identify that and other areas, I can imagine that there are people out there who would have limited understanding of financial matters—

Senator MURRAY—They are unlikely to have enough money to put down a term deposit.

Mr Thorpe—I think there are two points. One is that there is clearly no identified market failure. The second point is that, even if there is—and I would like to come back to some other points on that—you identify what the costs and benefits of that are and whether they are warranted. If there is a problem with disclosure—and that has popped up in specific areas, such as interchange fees on credit cards or something like that—then you address that specifically rather than try to have a broad brush approach by way of the Financial Services Reform Bill.

CHAIRMAN—Are there any further questions? If not, thank you both for your appearance before the committee.

[4.01 p.m.]

D'ARCY, Mr Anthony Alistair, Manager, Legal Counsel and Company Secretary, Securities Exchanges Guarantee Corporation Ltd

CHAIRMAN—I welcome the representative of the Securities Exchanges Guarantee Corporation. We have received your submissions Nos 47 and 47A. Do you wish to make an opening statement?

Mr D'Arcy—There are three brief points I would like to make this afternoon. The first is that the bill contains a proposal which is supported by SEGC which, if implemented, will have a significant impact on the operation of the national guarantee fund. That is the proposal to split the fund. At the moment, the national guarantee fund has a dual function. It operates an investor protection and compensation regime in relation to defaulting—to use a loose term—ASX brokers, but it also provides clearing and settlement system support by providing financial backing to the ASX related clearing houses. In providing these dual roles, SEGC is unique in the world. The bill provides a mechanism to split the clearing guarantee fund component from the investor protection component. If implemented, it will leave SEGC and the national guarantee fund solely concerned with investor protection.

The details and mechanics of how the proposal will ultimately be implemented will depend to some degree on the regulations that are going to be passed under the bill, and this brings me to my second point. A lot of the details concerning many aspects of the operation of the guarantee fund are removed from the current act and placed in the regulations. The precise form and content of those regulations will be very important as far as the guarantee fund is concerned. All of the current claims provisions, for example, are going to be removed from the act and located in the regulations. A key issue will be how those claims divisions are in fact translated from the act to the regulations and whether they will provide sufficient flexibility to accommodate future developments.

While the explanatory memorandum has made the point that it is not intended that the regulations will make major changes to the claims provisions, it is impossible to assess whether this is going to be the case until we have actually seen the detail of the regulations. Unfortunately, the regulations have not yet been circulated for comment. Given that it is expected the bill will commence operation on 1 October, it does not leave much time for interested parties to review and comment upon the regulations. We believe it would be desirable for those regulations to be circulated as soon as possible so that the consultation process can begin prior to 1 October.

The final point I would like to make is a particularly technical one which appears in our written submissions and it concerns the issue of subrogation. While it is a technical point, it is a matter of vital importance as far as SEGC is concerned. Under the current Corporations Law—and no change is recommended in the bill—if SEGC allows a claim by an investor on the fund, SEGC is then subrogated to the rights of that investor. In other words, it stands in the shoes of that investor. It can pursue all of those rights and remedies that that investor has. It is a very valuable right as far as SEGC is concerned because it is one of the ways in which we can

replenish the fund. Since its inception we have paid out something over $30 million and recovered $20 million. The difficulty we face at the moment is that, the way we read the legislation—and this is the way we have always operated—the right of a person to make a claim on the guarantee fund should be contingent upon that person doing nothing to prejudice SEGC's rights of subrogation.

That, we say, is consistent with the underlying policy of the legislation. It in fact operates as a quid pro quo: the price for being compensated by the fund is to enable SEGC to stand in your shoes, pursue the ultimate wrongdoer and replenish the fund. A recent claim—and it has only arisen once in our history—has led to some court proceedings. A decision has recently being handed down—which I think I referred to in the submissions—which disagrees with that interpretation of the legislation. It highlights what SEGC believes is a loophole in the legislation. We are concerned that, in relation to not only that particular claim but also future claims, that loophole may very well be exploited by claimants because ultimately it enables claimants to enter into arrangements that deprive SEGC of that right of subrogation. It may be an innocent arrangement or it may well be an arrangement pursuant to a fraudulent scheme, but it has the prospect of removing funds from the guarantee fund and preventing SEGC from pursuing ultimate wrongdoers and replenishing that fund.

To put it in context, the current size of the guarantee fund is $160 million and the claim on which this issue has arisen is a claim on the claimant's assessment—which is not necessarily our assessment—for $20 million. So we say that potentially it is a very large loophole, and the court, in that case, did not feel able to remedy or close the loophole. The position taken was that if there was such a loophole and if the parliamentary intention was not adequately expressed in the legislation then that was a matter for parliament to remedy, not for the courts. We think it is an important thing that should be remedied by amendment, because if it is not then it means that ultimately investor confidence in the guarantee fund may be undermined. It may also have an impact on the proposal that I mentioned earlier to split the guarantee fund, because one of the things the minister has to be satisfied of before he can enable a payment to be made out of the guarantee fund to split the fund is that the guarantee fund has to continue to have adequate assets to meet potential claims. It is very difficult to assess that if the guarantee fund can be depleted in the way that I have mentioned. We would strongly recommend to the committee that amendments are necessary in the bill to overcome this. They are the three points.

Senator GIBSON—Have you gone the next step and sought advice to pass on to us about what amendments would be required to achieve the two objectives that you have just put before us?

Mr D'Arcy—Certainly in the past we have had some discussions with Treasury, in which we have identified the ways in which you could do it. We have not taken specific legal advice as to the form of words to be used, but I would envisage that it would be something very simple—namely, making the claimant's right to claim on the fund contingent upon not doing anything to prejudice our rights of subrogation. But it is certainly something that we can look at if that would assist the committee.

Senator GIBSON—What about your first point about the splitting of the fund?

Mr D'Arcy—Are you asking whether we have taken advice?

Senator GIBSON—What are you recommending to us to do?

Mr D'Arcy—We say that the loophole in relation to the right of subrogation should be closed, because if it is not then that may ultimately affect—

Senator GIBSON—Assume that we follow that up. You have just said some words that give us a clue to a recommendation to follow that line if we, as a committee, decide to do that. But back to your prior point of the splitting of the fund: what would be your recommendation to us?

Mr D'Arcy—The principle of splitting the fund is identified in the legislation, and it is a principle that we support. So, in terms of an actual amendment to the bill, we are not suggesting anything. We are highlighting the fact that how that split occurs and is implemented is, to some degree, dependent upon regulations that have not yet been drafted, so—

Senator GIBSON—I understand that. So you just want us to make sure that the regulations are appropriate for that split?

Mr D'Arcy—What I am saying is it would be nice to have those regulations as soon as possible because we would obviously want to make some detailed submissions about some of the mechanics of how that split is implemented.

Senator GIBSON—Thank you.

Senator COONEY—If you took that expression out, wouldn't that mean that the right of subrogation would give you the ability to get back more money than had been paid out? A lot of the money that should really belong to the person whose rights you are subrogating will be missed.

Mr D'Arcy—No. What happens is the claimant, the individual, is compensated by the fund with either replacement securities or a cash payment. We then stand in their shoes and we commence proceedings in their name against the wrongdoer—the broker who has engaged in the conduct. The damages that are recovered are damages that are commensurable with the claimant's loss, which is what they have already been compensated for by the guarantee fund. We are not looking to receive any windfall gain; we are simply looking to make sure the fund is replenished so that other investors and other individuals out there can be protected in the future.

Senator COONEY—I can follow that, but why are you worried about the extent of that payment? I cannot quite follow that. Isn't that section saying that you can get back what you have paid out?

Mr D'Arcy—That is right. We say if that was the effect of it then we are protected, but the way that this current court case has proceeded, it enables a claimant to enter into an arrangement perhaps with the wrongdoer unbeknown to SEGC, for example, releasing the wrongdoer. We can do nothing to stop it, so when we step into the claimant's shoes to pursue that wrongdoer, the wrongdoer waves the release at us and says, 'Sorry, you don't have any right of action against me.'

Senator COONEY—That is really an issue of whether or not you can take action in the person's name, isn't it? I cannot quite see why you want to remove that particular phrase. I understand you saying, 'We want the right of subrogation,' and that is not to be surrendered no matter what. I can follow all that, but I cannot follow how you think deleting that particular phrase—and I do not have the section in front of me—would remedy the problem.

Mr D'Arcy—No. Remedying the problem will probably involve adding words to the section to make it a condition, rather than removing words.

Senator COONEY—It might well be that they are a bit worried about the constitution and acquiring property without proper compensation. That might be why they have used that expression, I don't know. Have you looked at that?

Mr D'Arcy—No, we have not looked at that particular issue.

Senator COONEY—Thank you.

CHAIRMAN—As there are no further questions, I thank you very much, Mr D'Arcy, for your appearance before the committee.

[4.13 p.m.]

HAMILTON, Mrs Karen Leslie, General Counsel and Company Secretary, Australian Stock Exchange Ltd

KELLY, Mrs Paula Elizabeth, Deputy National Manager, Market Law and Policy, Australian Stock Exchange Ltd

CHAIRMAN—Welcome. We have not received a written submission from you, so I assume you wish to make a statement before the committee. Following that, we will proceed to questions.

Mrs Hamilton—The Australian Stock Exchange has been an active supporter of a reform process designed to promote financial product market integrity and to contribute to Australia's economic efficiency, and in particular the global competitiveness of our financial services sector. We believe that the key concepts of a single licensing regime, harmonised regulation of financial products and recognition of different requirements for professional and retail investors are sound building blocks for this. We will welcome the ability which is provided by the Financial Services Reform Bill to restructure the National Guarantee Fund provisions. As you have just heard, the bill provides a mechanism to separate the clearing guarantee component from the fidelity component of the National Guarantee Fund. That separation will be in line with international clearing house practice and is accordingly very important to us in terms of our global competitiveness.

The Financial Services Reform Bill 2001 will also increase our shareholding limit from five to 15 per cent, which we wholeheartedly support. We are impressed by the magnitude of that which has been achieved in the bill and its supporting legislative infrastructure. We do not want to diminish the significance of that achievement. However, we do want to mention a few issues which, in our view, would appear to remain unsatisfactorily resolved, at least to our knowledge, at this point in time.

Perhaps it is appropriate in this context to revisit the last appearance of ASX before this committee to discuss the then draft Financial Services Reform Bill. In that context last year, we raised some concerns about the potential impact of the bill on Australia's international competitiveness. We noted that overall the effect of the bill was to increase regulation in the financial services sector. We expressed concern that many details of the total regulatory package that the bill will introduce, and with which we must comply, were not yet known. We also expressed concern about level playing field issues concerning foreign market operators and clearing house facility providers. Those concerns remain with us today.

As a securities exchange, we are competing in a contestable, rapidly changing, technologically innovative and globalising market. Electronic integration of markets is driving a need for international cooperation and supervisory frameworks that are flexible and that facilitate competition. Indeed, these are the stated aims of the Financial Services Reform Bill. In response to changing conditions, ASX has been developing a program of international strategic alliances. These are complex. The issues of sovereignty and the inflexibility and inconsistency between national regulatory models continue to pose challenges for achieving the benefits of

seamless integration between markets. That complexity has meant that we have seen very little in the way of true mergers between markets. By market capitalisation of stocks listed, ASX is now the 11th largest stock exchange. Given our relative size we recognise that becoming part of global securities markets is essential for our long-term growth, if not our survival. Accordingly, we have concentrated our efforts on international linkage proposals which fall short of merger.

Our structure, our strong technological platform and Australia's reputation for high integrity have been an advantage as we have pursued an international alliance program with other market operators. The model we have chosen recognises home market regulation and is designed to facilitate and provide a more efficient and cost-effective mechanism for cross-border trading. However, the time to market such a model is prolonged and painful as we pursue the path of seeking regulatory approvals in relevant jurisdictions. The current law simply does not contemplate exchange to exchange links. It provides limited opportunity to recognise the home regulation of exchanges, their supervisory infrastructure and the nature of the role played by exchanges in facilitating a link between markets. The Financial Services Reform Bill provides more flexibility generally but does not easily accommodate two-way links between regulated exchanges by promoting and encouraging even-handed recognition of home regulation and the reduction of unnecessary duplication.

In this regard, the Financial Services Reform Bill is something of a one-way street. It will facilitate the participation of overseas market operators and facilities providers in Australia. However, in return, it will not require reciprocity. As a result, the bill will not facilitate competition by Australian based market operators and clearing and settlement facilities in overseas markets. Australian based operators such as the ASX will remain subject to the barriers to entry which may exist in foreign jurisdictions. We are disappointed that this is the position. In the event that we overcome those overseas barriers, we will need to comply with both the foreign legislative regime and the Australian market or clearing and settlement facilities provisions in relation to our overseas activities. This is because the bill provides that a financial market, or clearing and settlement facility, is taken to be operating in Australia if operated by a body corporate registered in Australia.

We are concerned about the level playing field issues and the impact of duplicative regulatory burdens on the ability of Australian resident market operators and clearing houses to effectively compete in overseas markets. More broadly, we are concerned with the ability of the financial services sector to be able to efficiently comply with the new regime when there remains an information gap about its finer details and when significant policy issues are still being addressed. We note that larger issues about compensation arrangements have been referred to CASAC whose report is due by the end of January 2002. On 31 May we received further draft provisions of the bill concerning the regulation of clearing and settlement facilities and were requested to comment by the close of business on 6 June.

The proposed amendments will introduce a regulatory role in respect of clearing houses for the Reserve Bank. As a result, clearing houses will have two masters: the Australian Securities and Investments Commission, which will be responsible for fairness and effectiveness issues; and the Reserve Bank, which will be responsible for setting and assessing compliance with financial stability standards and with an obligation to reduce systemic risk. It is unlikely that the roles of these masters can or will be neatly ring fenced. We understand and are supportive of a regulatory regime designed to ensure systemic risk issues are appropriately addressed. That is

vital for Australia's financial stability. However, we are concerned that the approach being taken will impede our global competitiveness by further slowing down the process for business development by clearing and settlement facilities. That would be unfortunate, given the stated aims of the Financial Services Reform Bill.

When ASX appeared before the committee last year we noted that many details of the Financial Services Reform Bill were yet to come and would be set out in regulations and transitional provisions. We noted that it was important for the sector to be consulted about, and to have time to absorb, the implications of these. At the time of this appearance before you we are still seeing further fundamental revision to the framework for our regulatory oversight. We have recently seen the transitional provisions, although not those relating to the introduction of the Reserve Bank role in respect of clearing house operations, and we have yet to see the regulations. While this does not diminish our support for, and appreciation of, the nature of the fundamental reforms the bill will introduce, we cannot help but be concerned about the ability of the Australian financial services sector to be able to make a smooth and cost-effective transition to the new regime, particularly when aspects of its finer detail are still in play or unknown. We also remain concerned about global competitiveness, given the absence of a level playing field and the practical reality of electronic integration of markets and of regulatory duplication.

Mr RUDD—The overall burden of your submission, as I have listened to it is: do not regulate us more; it makes us less globally competitive. If it is a trade-off between consumer protection and global competitiveness: you give the latter a tick and the former a cross.

Mrs Hamilton—I do not think that is right. What we are saying is: we have no quarrel with the notion of protecting basic market integrity but we do have a quarrel with additional regulation if the benefits have not been proven. I can give you an example of the problems we are facing in relation to our international alliance proposals. We are trying to formulate a trading link with the Singapore Exchange, pursuant to which both exchanges are basically acting as conduits for trading activity between two regulated markets. We think that that will be efficient and cost-effective for Australian investors because, for example, it will allow an Australian investor to invest in Singapore securities using Australian dollars and have ownership records maintained in the facility they are familiar with, CHESS.

The issue that we have is: as we understand the situation from discussions with government regulators, ASX will, by virtue of providing that facility, be regulated as a dealer and as a market both in Singapore and in Australia, and it is likely that the Singapore Exchange will be regulated as a dealer and perhaps also as a market in Australia and in Singapore. It seems to us that duplication of regulatory endeavour is going to add costs which will be passed on to the users of that service, when those costs do not appear to be justified. The financial services reform legislation will improve the situation somewhat because it will give broad exempting powers to ASIC in relation to the financial service provider provisions. So it can say to the Singapore stock exchange, 'We do not require you to be treated as a full dealer. We do not require you to jump the hurdles that a full dealer would have to jump.' It will also enable ASIC to advise the minister that they believe there is regulatory equivalence between jurisdictions, so it will let Singapore come in and not have to jump the market hurdles that exist in Australia. But the situation will not be true in reverse for the Australian Stock Exchange. We will still be regulated as a dealer and as a market in both jurisdictions, and that is problematic.

Mr RUDD—Presumably we are not Robinson Crusoe on this question. If you go through all the European exchanges, you have parallel tensions between regulators seeking to protect consumers as well as regulators seeking to protect overall financial stability and public interest concerns on the one hand, and the push towards integration of global competitiveness on the other. Have you benchmarked where we stand in terms of quantums of regulation against both sets of policy objectives here as against, say, comparably sized European exchanges?

Mrs Hamilton—It is difficult to do a true benchmarking exercise because the flavour of regulation does differ from country to country, but it is my gut feeling that we are fairly highly regulated.

Mr RUDD—I suspect that, notwithstanding the merger/strategic alliance developments which are occurring within the European Union, for a lot of Brits in particular but Germans as well the regulators are still by and large having their way because the consumer push for protection within those jurisdictions, leaving aside the stability argument, is significant as there is a broadening of the share ownership base.

Mrs Hamilton—We have no quarrel with the protection of market integrity and with the rights of consumers. What we do have a quarrel with is duplication, unnecessary compliance costs being imposed on parties and the one-way street which the Financial Services Reform Bill will provide. It will allow foreign competitors to come in and compete in this market—which is fine; we are quite happy to embrace competition. But it would be nice if, while we are trying to create highways, the Financial Services Reform Bill would facilitate that process and require reciprocity. That is not going to be the case. Again, while I am not trying to diminish the importance of market integrity—it is how the ASX earns its dollars, because of the understanding and reliance on the integrity of the market we provide—Australia is very small. We are not as able as some of the bigger markets to afford inefficiency, in terms of duplication, in our regulatory framework.

CHAIRMAN—With regard to the concerns you raise in relation to the draft bill, you might recall that in our report we recommended particularly that the transitional administrative measures suggested by the ASX be adopted in the final legislation. Are you saying that they have not, or not to the extent that you would want?

Mrs Hamilton—I do not believe they have. We are all currently pulling off our printers transitional provisions, policy statements and so forth, which are the fabric by which we will have to live in the near future. We are still trying to absorb and understand the transitional provisions—because they are quite complex in their drafting—but our initial reaction to those is that, while we are touting a two-year transitional period to allow industry to come to grips with all of that, that transitional period will really only apply if you are prepared to set your business in stone. If you are looking to innovate or embrace new business activities, then you will not have a two-year transitional period.

Senator COONEY—Can I follow on from what Mr Rudd was asking? Are you saying that, as far as Singapore goes, we should have only one set of regulations, say, in Singapore?

Mrs Hamilton—I am saying that if we are satisfied of regulatory equivalence then there will need to be a cooperation between regulators, but we do not need two sets of regulators to

regulate the same activity, particularly in this context when what we are talking about are two regulated exchanges simply providing a trading link between those markets.

Senator COONEY—Are you saying that the Australian government should cooperate with the Singapore government to ensure that there is one set of laws?

Mrs Hamilton—No. I think harmonisation of laws is a very difficult task. I may not see it in my lifetime. All I am saying is that the current legislation involves issues of duplication and wrong fit. Merely the act of providing information in another jurisdiction suddenly constitutes you as a market provider, and equally the same applies in this jurisdiction. We do not look to the practical reality and say, 'This activity is regulated and we are happy with the regulation that applies to it in that other jurisdiction. We are going to look at this as exactly what it is: merely a technology link between markets.'

Senator COONEY—I can follow that, but what I can't quite follow is the mechanism by which you want to get there. Are you saying that, if there is a transaction which involves the Australian Stock Exchange and the Singapore stock exchange, one or other of the regulatory regimes ought to operate? Is that what you are saying: if one operates then the other ought to drop off?

Mrs Hamilton—The trading link model we have put in place recognises the home jurisdiction of the securities. Say, for example, I am an Australian investor and I want to use the trading link to acquire Singapore securities, then all the rules and regulations pertaining to Singapore securities of the Singapore Stock Exchange will apply. The benefit I get, though, will be I can do the trade in Australian dollars and have my ownership records maintained in Australia on CHESS, things that I am familiar with.

Senator COONEY—But using Singapore law.

Mrs Hamilton—But the Singapore regime is applying, so in our argument there is no need then to regulate the Australian Stock Exchange as a market because we are not providing a market; it is just a link through.

Mr RUDD—You mean for the purposes of that transaction?

Mrs Hamilton—For the purposes of that transaction.

Senator COONEY—So what you want is for the Australian parliament or the Australian government to create a regime under which, in the circumstances that you have described, Singapore law operates.

Mrs Hamilton—Yes.

Senator COONEY—I can follow that, and that is a matter of convenience, but you then went on to discuss competitiveness and efficiency. I was not sure whether that was a separate point or the same point. When you said we have got to have a competitive stock exchange and, as we are a small market, we have got to be out there and compete, was that the same point that you were making?

Mrs Hamilton—I think it was a slightly different point. It was a point more towards the cost of compliance with any regulatory regime and, in the context of being asked about a benchmarking exercise, merely noting that Australia is very small, so we can withstand less inefficiency in our regulatory framework in terms of compliance cost than a much larger market, for example the United States.

Senator COONEY—Do you say that, therefore, we should have a lesser regulatory regime than operates in the United States?

Mrs Hamilton—No, I do not. I am just saying that I believe we have to be careful to ensure that the benefits of regulation truly outweigh the burden of the cost of that regulation.

Mr RUDD—Can I just take Senator Cooney's point down to a point of individual application? I think the principle you are explaining to us, which frankly I was not aware of, is that with the exchanges you are now adopting what is a reasonably longstanding practice in other regulatory environments—mutual recognition. Historically, within the European Union, it has most recently been between the Australian states on various matters, but now essentially what you are talking about is exchange regulation as well. You would be highly selective in making those decisions about the exchanges, presumably post Nick Leeson, with which you would be happy in terms of the calibre and quality of the regulatory regime.

Let us just take it down to an example. I rock along to my local accountant. He is a CPA and in an indiscreet moment he says, 'You should buy SingTel, Mr Rudd.' Of course, he would be kicked out of the CPA for providing that advice because he would unlicensed to do so. Let us just say there are rogue accountants in Brisbane who might do that, so I rock along to my Brisbane broker and say, 'I want to buy a squillion SingTel, thank you very much.' We have the normal CHESS transaction, pay for it in Australian dollars and I buy 10,000 SingTel shares. Using that as the example, what then goes wrong, in terms of the jurisdiction as it would be amended as a consequence of this legislation, in terms of its non-reciprocity from the exchange's perspective?

Mrs Kelly—We should be careful about taking the Singapore example as trying to illustrate that what on the face of the FSR Bill looks very exciting as far as facilitating international activity is concerned is actually quite limited. That is just one comment I want to make as to why we are zeroing in on Singapore. I think, without getting into the detail of how the linkage works, you can have a number of misconceptions. When we are talking about mutual recognition or recognising the home jurisdiction, it is not for all purposes, so there is still Australian law applying to how that Australian broker is choosing to advise the Australian investor. What it is saying is that, when we are getting to the parts about regulating the market activities or regulating the role of the exchanges in providing those linkages, what you are seeing is a classic case of a friction point between different regulatory regimes. Our own regulatory regime at the moment and the regime of Singapore, for example, will analyse that and say, 'Your activities—tick—constitute a market. Your activities—tick—also constitute a dealer because of the kind of agency type role you are performing.'

Mr RUDD—Let me just cut across your tracks there, because I may be being unfair in asking such a practical example question, but in the business of politics we often deal with practical examples. Could you come back to the committee just with how a given transaction through the

exchange would work under current arrangements and under the new arrangements, and what you see the downside as prospectively being as a consequence of non-perfect reciprocity or non-dual carriage highway, to use Mrs Hamilton's earlier analogy? I would be interested in what actually materially gets in the road.

Mrs Kelly—Can I just clarify that when you talk about the current arrangements you are saying, 'Tell me the difference between how your proposal would operate under current Corporations Law versus FSR law, and tell me where your impediments are'?

Mr RUDD—Yes, and I am also asking where you believe the impediments will be under the new set of regimes against what you would ideally like. I know that you are moving from a base up to a new level, but I think the burden of your critique is that you would like something somewhat more streamlined than is currently being proposed. Please do so on the basis of investor Rudd wanting to purchase 10,000 shares in Singapore Telecom using the proposed new regime. How would the impediments be experienced either by the consumer or by the exchange? Is that okay?

Mrs Kelly—Yes.

CHAIRMAN—I think it will help the committee clarify the issues that you are requesting.

Mr RUDD—Take your time—but I would be very interested in that.

Mrs Kelly—In some ways the short answer is that the impediments are not increased under the FSR Bill; it is that they are not reduced. There are some areas in which we make progress, and that is part of this one-way street.

CHAIRMAN—Mr Rudd is asking what the impediments are now under the Corporations Law, what they would be under FSRB and what they would not be under what you are ideally seeking. There are three paths.

Mrs Kelly—Thank you for that clarification. It is helpful.

Senator GIBSON—Regarding your concerns as an international centre, we set out, in our August report, most of them. Did that adequately represent your concerns? I do not know if you recall our report—there are a couple of pages of detail.

Mr RUDD—It is a very well-read document.

Mrs Hamilton—Of course it is. We were very happy with your report and recommendation.

Senator GIBSON—Given that, are you recommending any changes to this bill that we should be considering?

Mrs Hamilton—We would have liked that bill to have accommodated your recommendation, but we do not believe that that was so.

Senator GIBSON—Directly in the bill? You are saying that you are concerned that it appears likely that these issues, which you have raised with us and which we considered and recommended in favour of, will be considered as part of the regulatory regime?

Mrs Hamilton—I do not think it is being addressed in the regulatory regime. I think the bill makes it quite clear that there will be no reciprocity.

Senator GIBSON—Do you think they have been skipped altogether?

Mrs Kelly—I think the explanatory memorandum makes it clear that there is no concept of reciprocity to be built into the FSR Bill, and, obviously, Australia cannot control the legislation of others. We can impose that reciprocity element—we can do that, but we cannot actually change the laws of other countries to achieve that.

Senator GIBSON—What do you want us to do? We can make a recommendation to change this or we can make recommendations to try to influence the regulatory regime—which is in process right now.

Mr RUDD—It would have to be changed—

Senator GIBSON—That is about all we can do.

Mrs Kelly—One possibility is that it is put on the basis of reciprocity, which would say that if we are to have alternative criteria for overseas operators to enter our market then the basis on which that would operate is contingent on those overseas jurisdictions having equivalent arrangements for us. I think that has probably been rejected fairly strongly by the government today—but that is the basis on which reciprocity would work.

Mr RUDD—That would be a statutory change.

Senator GIBSON—Would you write a letter to us on that very point?

Mrs Kelly—Yes—point taken.

Senator GIBSON—Then we can see where to go from there.

Senator COONEY—In your letter, would you say whether you want to do that by way of treaty or how you otherwise would do it?

Mrs Kelly—I will take that on board, thank you.

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

[4.39 p.m.]

LEFTAKIS, Mrs Maria, Managing Director, Georgeson Shareholder Communications Australia Pty Ltd

CHAIRMAN—Welcome. We have before us your submission, which we have numbered submission 1. Are there any alterations or amendments to the submission?

Mrs Leftakis—No.

CHAIRMAN—Do you wish to make an opening statement? If so, you may proceed and then we will move to questions.

Mrs Leftakis—I am here to address the committee on Georgeson Shareholder's submission to the proposed amendments to the Financial Services Reform Bill and, in particular, to address the committee on late amendments to part 2 of schedule 3 relating to the recording of calls during takeovers. Georgeson Shareholder forwarded submissions to the committee on 12 April. Firstly, I would like to thank the committee for your invitation today to speak to those submissions which are in front of you.

In our submission we said that Georgeson Shareholder is a specialised shareholder telephone canvassing and research company. Georgeson Shareholder operates globally in proxy solicitation, takeovers, corporate governance issues and other shareholder telemarketing and communications programs. Georgeson Shareholder acquired the Australian firm of Liberty Response earlier this year, and Liberty Response now operates as Georgeson Shareholder in Australia. Liberty Response has conducted shareholder telephone canvassing in takeovers and mergers exceeding $22 billion in value, and Georgeson Shareholder presently employs up to 100 full-time and part-time staff.

We are currently building a major shareholder contact centre in Sydney that will provide up to 65 new full-time and 200 new part-time positions. Telephoning shareholders and receiving calls from shareholders is, therefore, an important contact channel to us and one that we substantially depend upon to operate our business, and to generate income. Our submissions were therefore based solely on the proposed late amendments to part 2 of schedule 3, whose author, it seems, remains anonymous.

Our reading of the proposed amendments leads us to the inescapable conclusion that the author, with respect, may not have had a complete understanding of either our industry or the processes that establish, operate and control shareholder telephone canvassing in Australia. Briefly, shareholder telephone canvassing has been used in Australia since 1983, when there were only about four million Australian share investors. But because shareholder telephone canvassing usually deals with takeovers, mergers and transactions where people are being asked to accept an offer or to vote their shares, it has developed quite different characteristics and conventions from other types of shareholder or investor telephone canvassing, such as that for financial product marketing or sales calls.

It has maintained a very low profile, chiefly for two reasons. Firstly, talking to shareholders during a takeover means discussing their private investment business. Calls are always conducted on a confidential basis and the shareholder is always offered the opportunity to opt out at the start of the call, although opting out seldom occurs. Also, information gathered from these calls is never made public. Secondly, there is usually no controversy connected with the basic message, because Australian companies making takeovers or defending themselves from a takeover do not usually resort to deceptive behaviour or make false and misleading statements.

Today, calling shareholders during a takeover or a merger is considered an essential communications channel by corporate advisers, legal firms and the business community. Many hundreds of thousands of shareholders are telephoned each year during takeovers and mergers. Therefore, the statement contained in the explanatory memorandum that, 'The telephone calls are generally not intended to provide further information but to canvass the opinions of shareholders in relation to the proposed takeover' is fundamentally incorrect. Small shareholders are telephoned for any number of several good reasons. These include—and bear with me—to increase participation in a merger voting; to establish that shareholders have received the bidder's or the target's statement and to arrange a remailing, if required; to clearly explain to the shareholder the terms of the offer or their board of directors' recommendations; to inform shareholders of a change to the price or value of an offer; to inform shareholders of an extension to the closing date of an offer; to inform shareholders of a change in recommendation by the board of directors; to notify a change in entitlement thresholds; to notify a change in the conditionality of a bid; as well as to canvass opinions of shareholders and, importantly, to provide an opportunity for shareholders to ask questions and to receive accurate answers.

This is how it happens: a written script based upon information taken from the takeover announcement, bidder's statement, target's statement or information memorandum is prepared. This script is usually prepared by the shareholder canvassing firm or is sometimes drafted by lawyers, corporate advisers or communications consultants. Under Georgeson Shareholder's terms of contract, the script must comply with current corporations, trade practice and privacy laws and must be signed off by the client's legal adviser prior to its use. Strict operational rules ensure that the information contained in the script, and only that information, is delivered to the shareholder. Comment, opinion or any casual observation by an operator is absolutely forbidden. Calling is monitored by supervisors to ensure quality control and includes script accuracy as well as script delivery. Mechanisms do exist to escalate calls to the client or to corporate advisers in the event that a question cannot be answered using the script.

Operators receive comprehensive training before each calling campaign, but the standing orders regarding script compliance remain the same regardless of the circumstances. Georgeson Shareholder's staff identify themselves to each shareholder they call, state the purpose of the call and give the shareholder an option to opt out before the script is delivered. This also covers potential privacy issues, because it gives the shareholder a choice of whether or not they wish to continue the telephone conversation. Telephoning shareholders is the only universal mechanism that enables small shareholders to receive timely information on a takeover that will enable them to make an informed decision.

It is worth noting that shareholders face a daunting task in trying to read, let alone understand, the contents of the bidder's or target's statement. Some of these documents are up to 500 pages long and weigh more than one kilo. I have brought a couple with me, and this one

actually says on the cover, 'This is an important document and requires your immediate attention. It should be read in its entirety.'

A telephone script encapsulates the essence of the takeover document without compromising its substance or intention and in this way performs a valuable service to the small shareholder who may have difficulty reading or understanding documentation. Moreover, shareholders can be accurately guided as to how they should complete acceptance or voting forms and can be given other practical information.

Turning now to the issue of misleading and deceptive conduct, in the extract from chapter 2 of the regulation impact statement entitled 'Telephone monitoring problems/options', the author states that during telephone conversations with shareholders, breaches of the proposed corporations act could take place, particularly in relation to misleading or deceptive conduct. The extract goes on to say that it would currently be difficult to establish that such breaches had occurred as it is unlikely that either party—that is, the company or firm making the phone call, or the shareholder in question—would have a record of the conversation. This is a bit like looking for evidence before a crime has actually been committed. The extract says, 'This problem was not identified in the financial services inquiry.' In our view, the reason why the problem was not identified in the FSI and, for that matter, in any other consumer or privacy legislation, either state or federal, is that, with respect, there is not a problem per se.

I would also like to draw the committee's attention to our concerns over the proposed section 648K amendment that the recording of shareholder calls must be announced to the shareholder. It seems that under the Telecommunications (Interception) Act 1979, failure to notify the other person that the call has been recorded would constitute a contravention of the act. This requirement actually creates a very difficult conflict in the shareholder telephone call situation. The reason is that by declaring that the call is being recorded, an artificial barrier is immediately created between the shareholder and the bidder or target due to a natural inhibition by many people to have their telephone conversations recorded. We strongly believe that the effect of announcing that a call has been recorded would be to deny the bidder or target their right to go about their legitimate business under the takeover regulations and to freely communicate with shareholders. Moreover, from an economic point of view, this would result in far fewer telephone calls being accepted by shareholders. That would impact negatively on the income of firms offering shareholder canvassing services.

I would like to point out to the committee that there are clearly exceptions to this requirement. I can give the example of stockbrokers who record all buy and sell orders and simply use a tone signal, and the banks, who similarly automatically record foreign exchange orders and other such transactions without declaring verbally that the caller is being recorded. In other situations it is common for organisations to state that the call may be recorded for the purposes of quality control and allow the caller to opt out of the recording requirement. But this, in our view, is not appropriate for calling shareholders.

As I said in our submission, to our knowledge there have been no recorded incidences of misleading or deceptive conduct from companies or firms like ours telephoning shareholders during takeovers. Since its establishment in 1997, Liberty, which is now Georgeson Shareholder, has conducted a substantial number of shareholder canvassing campaigns by telephone and spoken to many hundreds of thousands of Australian shareholders. We have not

observed, nor have had reported to us any instances of such conduct, nor have we been approached by the Australian Securities and Investments Commission, the Australian Consumers Association, the Trade Practices Commission, the Australian Shareholders Association, the state privacy commissioners, shareholders, members of the public or their legal representatives as to such conduct.

We are also not aware of any such incidents having been reported in the Australian media, nor any member of a parliament making specific allegations of such conduct in relation to shareholder canvassing during a takeover. Yesterday you heard it directly from the Australian Consumers Association and from the Financial Services Consumer Policy Centre that they are not aware of any complaints arising from shareholder telephone canvassing during takeovers. In fact, there has not been a problem for a very good reason. I refer you to ASIC policy statement No. 25 covering takeovers and false and misleading statements, dealing with section 995 of the Corporations Law, paragraph 25.4. It reads:

Subsection 995(2) prohibits a person from engaging in conduct which is or is likely to be misleading or deceptive in, or in conjunction with, among other things, the making of takeover offers or a takeover announcement, or the making of an evaluation of, or of a recommendation in relation to, takeover offers or offers, or offers constituted by a takeover announcement.

The penalties for such behaviour are severe and ASIC has both civil and criminal remedies.

As a reputable firm whose very lifeblood depends on shareholder contact, ASIC's policy statements find deep resonance with us. The reality is that to make a false and misleading statement or to engage in deceptive conduct would require a conspiracy involving at least four parties: the company making or defending the takeover, its corporate advisers, its legal advisers and the shareholder canvassing firm—all this under the nose of ASIC. I believe that in a nation of 11 million shareholding Australians such a conspiracy is highly unlikely and that the vast majority of our public companies, despite the vagaries of the market and the economy, do not set out to deliberately mislead or deceive shareholders in takeovers.

Yes, complaints do arise. Most often they relate to how a shareholder feels about a takeover and occur when that individual expresses themselves strongly. People do get angry and frustrated about finding themselves in a situation where they are unable to influence an outcome. This is human, and we have mechanisms in place to deal sympathetically with this. It is also a reason why we believe the government should consider mandatory voting quorums at company meetings, as is required in other countries such as the United States and Japan. A quorum ensures that the small shareholder's vote does count. People do sometimes object to being called because the timing may inconvenience them. We have mechanisms which deal with those situations too and almost always result in an agreed time to talk being set.

Since the early 1990s almost all significant takeover offers, mergers, demutualisations and government and non-government IPOs occurring in Australia since have deployed shareholder telephone canvassing. Since at least 1995, without any persuasion or coercion by regulatory authorities, state governments, legal or consumer groups, shareholder telephone canvassing firms have consistently self-regulated their activities. Moreover, we are not aware of a single case brought before a court by any consumer group, privacy commissioner or any order issued by ASIC in relation to a shareholder telephone canvassing firm for misleading or deceptive conduct. In a global context, Georgeson Shareholder communicates annually with more than

100 million shareholders. In the world's largest mergers, acquisitions and capital market, the United States, a problem of deceptive and misleading conduct during telephone canvassing of shareholders has not been identified by the Securities and Exchange Commission.

Turning now to calls made by shareholders during the takeover, the committee might not be aware that many hundreds of thousands of shareholders make calls to toll-free numbers each year to obtain information about takeovers. Usually the inbound shareholder information service and the outbound shareholder calling campaign occur concurrently. Shareholders are actively solicited in letters, bidders and target statements, advertisements and press releases to call the toll free number for information. We are at a loss to understand why inbound calls have been exempted from the proposed amendment.

In its conclusion, paragraph 2.95 of chapter 19, dealing with telephone monitoring during takeovers, says that the most straightforward and cost-effective means of dealing with this 'problem'—that word again—is to introduce the taping of telephone conversations to shareholders initiated by bidders and target companies.

On the issue of taping telephone calls as a 'straightforward and cost-effective means'—nothing could be further from reality. In a modern technical call centre environment, digital not tape recording is the most effective system. It is the only system that could possibly accommodate recording detailed indexing, filing and retrieval of shareholder phone calls on the onerous scale suggested by the proposed amendment. This means an outlay of at least $200,000 if you have a digital telephony switch or up to $600,000 if you do not. Ongoing maintenance and storage costs would be in the vicinity of $120,000 a year.

We are in an industry of very tight margins, where call centres are fighting for survival in the fallout from the call centre boom in the late nineties and the subsequent tech crash and decline in company spending since November. The kind of spending required to meet the proposed recording amendments, in conjunction with shareholders not wanting to be recorded, would force some call centres out of business and cost jobs.

Clearly, ASIC's present rules and penalties over misleading and deceptive conduct during takeovers have been highly successful in maintaining the integrity of compliance by companies canvassing shareholders by telephone during takeovers. This has occurred while Australia's share ownership has grown to one of the world's largest per head of population. The situation really is that the history, management, practice and behavioural record of shareholder telephone canvassing in Australia is unambiguously clean. We run very tight systems with strict reporting mechanisms and disciplined script delivery. Our track record attests to the fact that we self-regulate to a very high degree and that we are aware of and compliant with our legal and privacy obligations and responsibilities. We believe the same is true for other firms operating in our industry. Were there in fact a genuine problem in this area then we would suggest that there could be a system of continuing voluntary compliance with the act, whereby companies, corporate advisers, legal firms and shareholder canvassing firms continue to prepare scripts which are deemed to comply and which are subsequently lodged with ASIC as a matter of record. Lodgment of that script with ASIC would be intended only as a measure of good faith and we would in no way be seeking for ASIC to be involved in the drafting, editing, screening or approval of any telephone script, because we do not believe this is necessary, given the existing processes that already support complying scripts. Timing of such a lengthy approval

chain would also be problematic because some campaigns are set up and run at very short notice.

Therefore, in conclusion, so far as the amendments before you relating to the recording of shareholder telephone calls are concerned, we believe that no special provisions in law need be made to regulate the conduct of shareholder telephone canvassing during takeovers other than those already prescribed in section 995(2) of the Corporations Law with its attendant penalties. We do believe, however, that all shareholder telephone scripts should contain an opt-out question and continue to be approved by legal advisers and by the companies seeking their use.

Finally, I would like to thank you once again for giving Georgeson Shareholder the opportunity to make these submissions on the proposed amendments and to offer you our full cooperation and assistance.

ACTING CHAIRMAN (Senator Gibson)—Thank you. Is it possible for us to have a copy of that document? I assume the committee will accept it as a document to be tabled. Do you have any questions, Senator?

Senator COONEY—No. I thought the points were made clearly. I do not need any elucidation.

ACTING CHAIRMAN—The chairman has had to go to catch an interstate plane and he apologises for that. We thank you for your submission and for coming along today and elaborating in detail the workings of your organisation. I do not have any further questions. Do you have any further comment you wish to make?

Mrs Leftakis—I do not have any further comment other than that our firm, whose only line of business is canvassing shareholders, was astounded—given there was absolutely no consultation—that an amendment like this was proposed, which is also tabled in the regulation impact statement. We are very surprised that this has come out with absolutely no background or research done.

ACTING CHAIR—Other witnesses have made the same point to us and the committee has taken that on board quite strongly, let me assure you. Thank you very much for coming along today.

[5.01 p.m.]

ANDREWS, Mr David Ronald, Managing Director, Glebe Asset Management Ltd

MATHER, Mr Erik, Senior Manager, Institutional Business, Westpac Investment Management

MATHEWS, Ms Sue, Convenor, Ethical Investment Working Group

WADE, Ms Felicity Jane, Disclosure Project Officer, Ethical Investment Association

ACTING CHAIR—Welcome. Do you have any comment to make on the capacity in which you appear?

Mr Mather—I am a committee member of the Ethical Investment Association.

ACTING CHAIR—We have received your submission. Do you have any corrections to that submission?

Ms Wade—No.

ACTING CHAIR—I think we had a previous submission from you also, and one of your representatives appeared before us at a Melbourne hearing.

Ms Wade—I think it was the Australian Conservation Foundation.

ACTING CHAIR—Yes, it was. Do you wish to make an opening statement?

Ms Wade—Yes.

ACTING CHAIR—We are running out of time, so I urge you to get straight to the key points, please.

Ms Wade—Yes. We are fully aware that we are at the end of a very long couple of days. I represent the Ethical Investment Association and we are here to support the amendment to part 7.9 of the Financial Services Reform Bill 2001 which has been put up by the Australian Conservation Foundation. We believe the amendment will do two things. First of all, it will facilitate good choice by consumers, by virtue of giving them information. Secondly, it will facilitate the growth of the socially responsible investment industry.

The Ethical Investment Association is the new industry body for the emerging socially responsible investment industry. We have got 60 members, and we are incredibly diverse. Our members are major financial institutions, financial planners, consultancy groups, universities and community groups—the whole gamut. Our aim is to bring those diverse interests together to get a coherent strategy on building a robust SRI—socially responsible investment—industry in Australia. It is important to note here that, while we are supporting the Australian

Conservation Foundation amendment, we do not necessarily endorse the broader policy platforms of the Australian Conservation Foundation.

KPMG/Resnik Communications surveying last year showed that 69 per cent of Australians would consider socially responsible investing if given the opportunity. Surveying constantly shows that lack of access is the main impediment to the growth of the socially responsible investment industry. So our support for the amendment is primarily about consumer access to information. You would be aware that there is a whole shift occurring in the financial services industry. It is no longer good enough to just say, 'Give us your money and trust us.' The imminent superannuation members' choice legislation is proof of that, as is this entire bill, which recognises that consumers have a right to financial services that reflect and suit their needs.

We believe that the bill as it stands makes an unnecessary distinction between financial needs and the needs and priorities in other sections of people's lives. It is out of touch with where the consumers are at, and it is also out of touch with worldwide trends that are recognising that environmental and social concerns are central to business and financial services—they are no longer a marginal issue. Basically, transparency and disclosure are central to good consumer choice. Furthermore, transparency and disclosure are essential to a robust socially responsible investment industry. As I have said, we are a very diverse group. SRI is by no means a monolithic thing. We have no agenda of describing what might define as 'ethical'. Within our membership Glebe Asset Management, for instance, use a Christian framework to decide their ethics around choices of investment.

Westpac surveyed the market and found that the environment was something which people were concerned about and made their focus. Australian Ethical Investment has a strongly environmental and humanitarian perspective whereas Hunter Hall—another of our members, which manages $109 million worth of investment—see themselves as everyman. They are a bunch of investment professionals who want to be able to sleep at night. All of these very different ethical frameworks are held under the SRI umbrella. So I guess it is important to say that we are not prescribing ethics at all, but our aim is to provide a marketplace where people can have their ethical concerns and their investments tailored to that. Technically, socially responsible investment is any investment that considers non-financial—

Senator COONEY—A bit of decency in the system.

Ms Wade—Yes, that is it. That is exactly it.

ACTING CHAIR—We may get some decency yet right through the system.

Ms Wade—That is the core of what we are talking about. I know that there have been some concerns raised about this issue, this lack of definition about strict liability, and we just want to make it clear that the SRI industry deals with this a lot and, of course, if false claims are made, then people are liable for that. The way the SRI industry is generally dealing with it is to make sure that any disclosure, any claim that they make, is based in fact; that there is an avoidance of motherhood statements and so on. In that way, fund managers will be protected from that problem.

The EIA believes the amendment will help bring Australia into line with international best practice. The Netherlands, France and Germany are all considering similar disclosure laws at the moment and, as you are aware, in the UK last year in July they accepted an ethical disclosure responsibility for pension funds. The Australian Conservation Foundation proposal differs from the UK example in a number of key ways. The proposal is broader—it is not just pension funds, superannuation funds, but all managed funds—and it is also applied at the retail consumer end of the process rather than at the investment stage by trustees. EIA supports the Australian Conservation Foundation proposal as timely and appropriate to the Australian context and the legislative framework. It fits neatly within the Financial Services Reform Bill's aim to centralise disclosure provisions across the industry. It is only sensible to include the amendment at this time, and it is the way that things are going to keep going.

EIA fully understands there is work to be done over disclosure for the trustee end of things, for the way super trustees design investment. We are initiating discussions across the industry on this issue, but this does not invalidate this initiative for providing disclosure to consumers. It is not a matter of either/or. We need to make sure that, at all levels, we know what is going on and that people have these choices. The value of this proposal, in particular, is that the consumer concerns will be fed back to service providers rather than the other way around, allowing the market to drive the scope and nature of ethical considerations in investment services.

The only other thing I would like to quickly mention is this issue of concern about compliance costs being onerous and that, in fact, this sort of disclosure should be left in the realm of marketing. We do not believe that compliance will be expensive. The relevant decisions are consciously made and articulated at the design stage of investment. It is simply a matter of disclosing such. EIA believes it is a modest impost compared to the value it will provide investors in making good choices.

With me I have Eric Mather from Westpac, Sue Mathews from the Mullum Trust and the Ethical Investment Working Group, and David Andrews from Glebe Asset Management. Glebe Asset Management is the largest ethical investment house in Australia. Westpac Investment Management—as I am sure you are aware—manages $20 billion worth of funds. Westpac has made the corporate shift in recognising that across the financial and banking sectors environmental and social issues are no longer marginal; they are the key to how business is done. It is a worldwide trend that I think this amendment gives us an opportunity to be at the front end of.

The *Financial Review* two days ago reported that the WTO, the World Trade Organisation, has placed environment and social obligations as part of their responsibility. It is in this context that Westpac Investment Management has supported the amendment. Shaun Mays, who is the Managing Director of Westpac Investment Management, said:

We recognise the changing nature of investment markets and the circumstances within which organisations such as WIM operate. Specifically, we acknowledge the growing trend to individual responsibility for investment decision-making, a trend that has been driven by policy initiatives (for example superannuation and privatisations), as well as the effect of market forces such as demutualisation.

In this context, the creation of uniform disclosure obligations in relation to financial products is an important development. WIM has been carefully monitoring global developments in this area and the movement toward screened investments has been regarded as one of the most apparent trends of recent years

… … …

WIM therefore fully supports your—

the Australian Conservation Foundation—

proposal ...

Erik is available to answer questions but now I would like to hand over to Sue to make a statement, as well as David.

Ms Mathews—I have got a copy of what I am going to say. Can I give that to you?

ACTING CHAIR—I know Senator Cooney has to leave in about five minutes.

Ms Mathews—That is about how long I am going to take.

ACTING CHAIR—Perhaps you could table that and speak to the key points.

Ms Mathews—The group I represent is a group of foundations, trusts and individuals. We are based in Melbourne. We include the Myer Foundation and a number of other trusts and foundations, and we represent about $200 million of investment. In the context of why we are here today, we are a group of consumers of financial products. I do not know how many consumers you have heard from. What brought us together was realising that the things we were funding with our giving programs were often being undercut by things that were being done with our investment money. On the one hand some of us found that we were funding antigambling programs while on the other hand our investment arm was investing in casinos.

The other thing that brought us together was finding that, when we began to try and do something about that, we met incomprehension and scepticism from our investment people. So what we decided to do was to get together and fund a report by the Allen Consulting Group. We decided that the most useful thing to do was to go to some people who would be listened to in the finance sector. We produced this report, which you have probably seen. Dr Vince FitzGerald was the leader of that. I can table that as well; it is titled *Socially Responsible Investment in Australia.*

ACTING CHAIR—Can we have that copy?

Ms Mathews—Yes, you can. You will have heard a lot of what it found in the course of these hearings, so I am not going to go over it for you—the size of the various markets and the growth of socially responsible investment. One of the things that is talked about there is the importance of disclosure, transparency and reporting, both by corporations in which people want to invest and by investment bodies offering business.

Senator COONEY—What you mean by disclosure is full disclosure, as Ms Wade said, of the whole ambit of things?

Ms Mathews—Exactly. And that was precisely what we were missing when we went to try and deal with these questions as investors. I can add to that something which has only been brought to my attention recently. There was a survey done by Monash University last year of members of three large superannuation trusts. Among the questions they asked was, 'What were some of the reasons why people did not want to invest ethically or socially responsibly?' I do not know whether I can table this document, but you can see there the two very big reasons—the preponderant reasons. One was 'not enough information' and the other was 'not familiar with the idea'. There is a huge gap in the market and there is a huge distance between people's desire and their theoretical interest in this kind of investment and what they know and understand.

Senator COONEY—When you say Monash University, do you mean the law school?

Ms Mathews—No. It was a group of graduate students within the environment management group, which is the group which undertakes the research that Westpac Investment Management uses as a basis for their investment. The other important thing to say is that the amendment that is being proposed will come in at the level of individuals making decisions, and I think that is tremendously important. It cuts into the system at a different point from the UK one. I think it can be seen as complementary to the impact of that kind of legislation. We need decent labelling of financial products. We do not want to force financial institutions to invest in particular ways but we want them to think about those issues and to let us, as consumers, know what their thoughts are.

ACTING CHAIR—Is it not true that we are actually seeing this happening in the marketplace right now? Individual firms are letting their shareholders and the general community know what they are doing, as are some managed funds for instance in terms of what they are investing in and what they are doing. Isn't the market already responding now to the trends which you are advocating?

Ms Wade—I guess you are arguing: let's do it through marketing rather than through legislation?

ACTING CHAIR—Yes. It is happening now, isn't it?

Mr Mather—The market is increasing in terms of the number of service providers offering these sorts of services, but there are the majority of investors for whom there is no disclosure as to the nature of the investment that is being made. The issue put forward by the Ethical Investment Association for your consideration is: how does that marry with the evidence that is increasingly abundant that individuals or consumers are concerned about these issues? There is a misalignment with how much information they are getting at this point in time. We do not pretend that this is not a difficult issue. In terms of Westpac Investment Management, the support is for a basic level of disclosure. In fact, it would be in our best interests to oppose this disclosure, because we could try to carve out some sort of a commercial advantage, but in reality the long-term view is that people are wanting information in relation to this issue, and therefore we are supportive.

Mr Andrews—The other aspect which is worth noting is that with the market forces driving this there is a lack of precision in the disclosure of that ethical policy, which is concerning. There is a lack of definition, indeed, to that very label 'ethical'. There seem to be as many

ethical agendas as there are individual investors. The final point is that some of the so-called ethical investment funds are actually very thin in terms of their ethical techniques or their actual investment selection techniques. The investor is often left in a lot of doubt as to the extent to which the ethical overlay is applied to the overall investment fund.

More disclosure would force the fund managers in particular to think about their ethical policies, to describe them more clearly to be able to implement them and to describe them in a way which is consistent with the practical problem of implementing them. That would allow the individual investor to make a much more informed choice than they are currently.

Senator COONEY—You are saying the claim to virtue is overshadowing what is really a vice?

Mr Andrews—I was going to say, without sounding a bit self-righteous, that sometimes the credentials are not as strong as the marketing hype.

Ms Wade—There would probably be a bit of a distinction there in that the Ethical Investment Association is keen to give all of those people in the marketplace access to consumers. Obviously, everyone has very different standards. The other important thing to remember is that we are at the beginning of a shift on this. The distinction you are making is that this whole bill recognises that financial disclosure is really essential. To say that non-financial is the marketing issue is actually an ideological thing that does not face the 21st century shift—that, more and more, people need to be protected on their ethics as well as just straight financials.

ACTING CHAIR—Thank you for your submission and thank you for appearing.

Committee adjourned at 5.19 p.m.