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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Regulations and ASIC policy statements made under the Financial Services Reform Act 2001

FRIDAY, 12 JULY 2002

SYDNEY

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Friday, 12 July 2002

Members: Senator Chapman *(Chairman)*, Mr Griffin *(Deputy Chair)*, Senators Brandis, Conroy, Murray and Wong and Mr Byrne, Mr Ciobo, Mr Hunt and Mr McArthur

Senators and members in attendance: Senators Chapman and Murray and Mr Byrne and Mr Griffin

Terms of reference for the inquiry:

To inquire into and report on:

The regulations and ASIC policy statements made under the Financial Services Reform Act to ascertain the extent to which they are consistent with the stated objectives and principles of that Act.

WITNESSES

Committee met at 1.59 p.m.

CHAIRMAN—This afternoon the Joint Committee on Corporations and Financial Services is resuming its public hearings into the regulations and ASIC policy statements made under the Financial Services Reform Act.

Before we commence taking evidence, 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 or fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of any evidence given by that witness before a committee is treated as a breach of privilege. These privileges are intended to protect witnesses. I also remind witnesses, however, that the giving of false or misleading evidence to the committee may constitute a contempt of the parliament. Unless the committee should decide otherwise, this is a public hearing and therefore members of the public are welcome to attend.

[2.02 p.m.]

THORPE, Mr David, Associate Director, Australian Finance Conference

CHAIRMAN—Welcome. We have before us your submission, which we have numbered 25. Are there any errors or omissions in the submission?

Mr Thorpe—No.

CHAIRMAN—I invite you to make an opening statement, and following that we will proceed to questions.

Mr Thorpe—Thank you, and thank you for the opportunity to put our views to the committee. Not surprisingly, the tenor of our current submission is in some ways similar to our submission to the previous committee which examined the Financial Services Reform Bill. However, AFC members have now had more time to determine the likely impact of the legislation and the ASIC policy statements. The AFC does not object to the application of the legislation to financial planning, superannuation and life insurance, the more complex products which need more explanation and advisory skill. Others may argue along those lines, but from our perspective, if a customer asks for financial planning advice at the front counter then the customer will quite cheerfully be referred to a financial planner, whether within the organisation or external to the organisation.

Deposit products, however, are not in that same category of complex products, and the previous committee recognised that in its recommendation to exclude deposit products from the financial services reform legislation. We still strongly support that stand. Some earlier compromises were made by the government for basic deposit products and our members have looked at what they would need to do to comply. Our members, of course, can comply, but at a cost which we maintain is not necessary.

The big dollar item I want to highlight today is training: additional training of a vast number of front counter staff to meet tier 2 level, let alone tier 1 level. I would like to make it clear that we are in no way against training. Our members are very much for it and have been training their staff for many decades to the level required to be proficient. ASIC's PS146 imposes a new level of prescription. Again, our members have looked at what needs to be done to meet the training requirements. Again, it can generally be done, with the possible exception of agencies, a significant financial service outlet in rural areas. However, a certain level of additional cost is required even if our members conduct their own courses which are approved by registered training organisations, RTOs. We now find that apparently after this year, because of the requirement for all courses to be aligned with the financial services training package, which is in PS146, paragraphs 98 and 99, RTOs must themselves keep records on all trainees and issue all certificates of attainment. This will again increase the training costs enormously, which is a magnificent boon to the RTOs but a huge cost to the deposit taking institutions. Finally, as outlined in our submission, there is a lot of confusion about what is advice, with many financial institutions being told that

a financial services provider cannot issue a product without giving advice or coming so close to it they should play safe and assume the FSR Act advice provisions will apply. AFC believes it should only be true financial planning advice and advice on more complex products which should be caught by the legislation.

In summary, our members are concerned about the unnecessary and costly problems from the financial services reform legislation and I believe that the ABA, credit union services and AAPBS have also highlighted these concerns to you. Finally, it leaves us wondering why we are imposing such prescriptive and costly requirements on a group of well understood deposit products where there is no market failure. We ask the committee to consider our recommendations in the submission.

CHAIRMAN—Thank you, Mr Thorpe. I take it from what you have told us that your position is basically similar to that of the Australian Bankers Association and the building societies.

Mr Thorpe—I believe so, yes, and the credit unions.

CHAIRMAN—Apart from that issue of deposit products, are there any other issues of significance to you?

Mr Thorpe—None that I wish to highlight here today. I think they are the main areas of concern that we would like to address. The submission did mention a couple of technical issues which I am happy to address, but if they are things that come up in your further research I am happy to take those off-line. The main issue is the training issue and the question of advice.

CHAIRMAN—Have you been able to put any reasonably accurate numbers on the additional cost of training that might prevail?

Mr Thorpe—From a sample of our members, particularly with the significant cost that is going to come about if we have to have registered training organisations actively involved in keeping the records and giving certificates of attainment, the estimates, from the members I have talked to, range from $300 up to $1,000, particularly in regional areas, for each and every person who is trained.

Senator MURRAY—One could say that even prior to this act there were three tiers anyway. You could break up the various functions of information and advice provided into three tiers: basic product knowledge, if you want to call it that, as it has been described to us, and then there are tier 1 and tier 2, as per the legislation and ASIC's policy statement. The people making submissions to us have raised no complaint about the process with tiers 1 and 2 and registered training organisations, the way it is structured et cetera, though obviously there is discussion about the exact wording of the regulations.

With respect to banks and financial institutions, the claim has been made to us that they already have their own training systems for what is known as tier 3, including their own training manuals, because you have to provide training for a teller or an across-the-counter person. One option that this committee could look at would be for

ASIC to say, 'Well, there is this tier 3'—and let us call it basic product knowledge, basic transaction functions—'and, provided that the institution concerned has a training regime and training manuals that it might look at and tick off on, it would not be subject to the further regulation of the act.' That would ensure that a mechanism for basic training was there. I will ask first for your response to that.

I will continue just to give you the picture. Secondly, committee members in their questioning have shown concern at there being a cross-over point after which, if a customer were pursuing advice, the teller or the across-the-counter person might be 'offering financial advice', as determined within the ambit of the act. In each case the witnesses commenting on that said, 'Well, the proper approach then would be for them to be referred to the person with the training.' That would be whoever is the manager or the person with authority within that branch and so on. How do you react to those propositions: firstly, if you really have your training system at that third tier level, ASIC should just be able to tick it off so that you do not have any extra cost; and, secondly, an assurance is needed that persons subject just to tier 3 training have been trained to ensure that they pass across customers who are stepping into the financial advice arena?

Mr Thorpe—I will address the first point you have mentioned—no concern having been mentioned about the registered training organisations by other bodies. I wonder whether that is because at this stage it is not applicable but after the end of the year it will come in as a requirement. It took me some research, through talking to National Finance ITAB and other training bodies, to find out exactly what was required under the Australian qualifications training framework. As it started to unfold, I was surprised at just how much the RTOs would have a grip on the training programs and the training of individuals. So I question whether or not that is widely known and whether it has been costed by a number of other organisations.

Secondly, in relation to the tier 3 proposition, it is certainly an option. I would be concerned about any further prescriptions in relation to another tier of training. To date, because there have not been any expressed concerns and no known market failure in this area of inappropriate advice being provided by front-counter staff, it possibly is not something that would need any further prescription and should be covered adequately by current training practices. In any case, if deposit products remain under the legislation, there is still the overriding duty in section 912A. That ensures that all representatives, including staff, must be adequately trained to provide all financial services, including issuing and advising on deposit products. So the onus is already, without any further prescription, on financial institutions to ensure that their staff are trained appropriately.

That probably goes some way to answering the last point that you raised: the problem of how far a teller should go. I know that there is a problem of where you draw the line. Our problem is that the line is drawn so broadly at the moment that it covers many forms of very simple advice that a teller gives on a day-to-day basis, which does not have broad ranging financial planning implications. At the moment the definition of 'advice' is so broad that it covers a broader range of activities that it should not. So where do you draw the line? Again I would say, because of the overriding duty of the financial institutions in section 912A, they have that

responsibility in any case, without any further prescription being required. Does that answer your question?

Senator MURRAY—Yes, that is helpful. Although there is that element to the act—and your quoting of it is very useful—that, in itself, is no guarantee that the training has been put in place. If you look at tiers 1 and 2, the act then goes on to say, 'Well, you have to have training, but we're going to tell you how you will do it; you'll have a registered training organisation and there will be this and this to comply with.' People in your industry argue that they do not want that applying to them in tier 3. All I am pursuing as a result of these discussions is the thought that some mechanism is needed whereby the ABA, the AFC, or whoever the industry association is, or ASIC need to be able to verify that there are manuals, training programs or whatever available for tier 3 so that that section of the act is complied with. Once that is done, you have then secured training at every level and you know that you have secured it. The question that is then left over is where you draw the line and whether the people who have been trained know that they must refer it on to a higher standard person. It is part of the training, of course, that when you are asked such-and-such a question, you can answer it; beyond that, you cannot. That is what I want to explore with you. It seems to me that the proposition I have put to you more easily covers the intent of the act without adding extra expense and extra difficulty for practitioners in the area.

Mr Thorpe—It is certainly an option. It does go some way towards resolving the problem. I would still have some concerns, on the basis that I do not believe it has been an identified problem of market failure at the moment requiring any government action in this area at all.

Senator MURRAY—Because you have used that phrase twice, perhaps I may interrupt you to say: except that both the committee and the parliament believe this is not a question so much of addressing market failure as of addressing consumer protection; in other words, giving consumers greater assurance that, in dealing with these matters, they will be given full professional advice. So it is a kind of assurance package more than a market failure—at this level anyway; that is, the level of tellers and across-the-counter service.

Mr Thorpe—I take your point on that. At the moment, even in the consumer protection area, there is still that concern that I have about further prescription and the fact that it would create cost. But there is a precedent in this area that ASIC is not proposing to put in any prescriptions in relation to matters other than advice. So, in the area of dealing, for instance, it is saying that it is not seeking to make prescriptions in that area. Secondly, with the overriding duty that I mentioned, the onus is on the financial institution in section 912A. Thirdly, ASIC already has very strong consumer protection powers in the ASIC Act as distinct from the Financial Services Reform Act; and those provisions in the ASIC Act prohibit unconscionable, misleading and deceptive conduct in any case. So, if any misdemeanours at any stage do pop up, ASIC already has quite adequate powers.

Mr GRIFFIN—Isn't this partly about trying to make sure that they do not pop up, that they do not start occurring? Isn't it about trying to ensure they do not occur as much as people suspect they may be occurring?

Mr Thorpe—I suppose, given that ASIC has those strong powers for remedy in any case, it would still require similar sorts of remedies if you did have higher prescriptive standards in place anyway—if they were breached, there is no guarantee that they would be followed. What I am saying is that there has been no breach to date and ASIC already has those powers to be able to act in any case if they do appear. But I am not sure that there is any evidence of them appearing.

Mr GRIFFIN—Bearing in mind that I have been out of the room, and I apologise for that, there has been a range of actions in recent times involving ASIC taking action regarding the behaviour of banks with respect to internal procedures, as I understand it. Senator Conroy mentioned that yesterday in response to Mr Gilbert from the ABA. As to whether in fact there has been no issue raised about this particular point, there have certainly been issues raised about behaviour and process within banks.

Mr Thorpe—Obviously, in those areas there is due process in place that allows ASIC to attack those.

Mr GRIFFIN—The whole point with that is that any process relies on people actually being in a situation where they are aware of their rights and notify the fact that they have a problem and therefore a complaint is made and action is then taken. You can have the strongest powers in the world around the question of being able to enforce a particular activity but, if you are not notified that that activity has occurred, you are not going to be able to do anything.

Mr Thorpe—I suppose we must not forget that we are talking about fairly simple sorts of transactions here. The risks of problems occurring at the front counter in relation to transaction and deposit accounts and term deposits are very small and the remedies are very easy. So it is not as though we are talking about rip-off schemes at all. It is very simple products that we are dealing with where the likelihood of problems occurring are very small and the financial implications of those occurring are very small.

Mr GRIFFIN—I do not want to go through everything that happened yesterday with the ABA. I do not think that would be particularly productive. It is on the record now and we can work off that for the future. There were some points made yesterday in respect of that. It was pointed out that counter staff, particularly at banks these days, are in fact in a situation where they often receive some form of incentive or penalty, if not for directing then at least for guiding customers into particular positions if they have to make a choice about what they do, whether that be a transaction account or some other form of program, and that should and could, by definition, influence the sorts of actions they take on the front counter.

In those circumstances, if that sort of activity is going to be undertaken, then the issue of what training people have in terms of providing advice would be relevant. Although it may not happen a lot, if there is still a chance of it happening, or an example of the fact that it could happen, where do you draw the line about where you do not train? You mentioned in your submission that only between two and three per cent of transactions that are handled actually fit in under FSR. Could you expand on

that and on how that would work in some of the institutions that you are talking about?

Mr Thorpe—Yes. During the day, for instance, a good teller would conduct 100 transactions—withdrawals, deposits, opening of accounts and the like. Of those 100 transactions in a day, there would be one to three that would actually involve the issuing of a financial product—in other words, opening an account. From a sample of some of the institutions that are our members, that was the range of accounts that would be opened that would require, under the current regime, this extra training proposal that ASIC has put up.

Mr GRIFFIN—Following on from that, what would you see happening under the current arrangements for those two to three per cent of transactions? If someone comes along wishing to open an account, what is going to happen then? Are you saying that, because it is only two to three per cent of transactions, staff do not require that advice and therefore they do not pass on any advice, or are you suggesting that they refer? Exactly what are you suggesting?

Mr Thorpe—What I am suggesting there is that, for such a small number of transactions conducted by the clerical staff at the front counter, it seems like a disproportionate cost for additional prescriptive training for those staff for such a small part of their business when training is already in place within the organisation itself covering the whole range of staff activities. Why do we need to go to this extra potentially $300 to $1,000 to deal with what would amount to a couple of transactions a day for a staff member when they are already trained in how to deal with these particular matters? Again, even if things go wrong—and there is no indication that they have—it is such a small part of the total number of transactions with such small financial implications.

In answer to your question associated with what would happen at the front counter, some of the difficulties we are seeing under the new regime, particularly in the smaller branches and the smaller institutions, are that when customers come in and the person behind the counter is not trained to give any sort of advice, they have to be trained to actually not give any advice at all. An example I give in the submission is of a customer who says, 'I don't like ATMs. I want to do my transactions through branches. Which is the best account for me?' Potentially, if the person behind the counter says, 'Here is the account that has the lowest fees for transaction accounts,' that could be taken as advice, and therefore that person would have to be trained up to tier 2 level to do that. If that person is not trained, they could not give that advice and either they would have to refer that person to somebody else or in a small branch, if that person is not there, they may have to ring up head office and talk to somebody there. So it creates quite a chain effect of potentially reducing the service in the smaller branches and agencies. Once you go to newsagents and chemists in the bush, it becomes even more of a problem. It really becomes quite impractical to have any sort of tier 2 training for people in those situations.

Mr GRIFFIN—What about the example that I think was used yesterday by Mr Byrne? What if someone comes up to the counter and says, 'I want to set up an account,' and that is as far as it goes?

Mr BYRNE—I think it was: 'I have $2,000. I want to know what to do with it.'

Mr Thorpe—The only thing that I could advise you, Mr Byrne, would be to say, 'These are the products that we have. If you are looking for financial advice, I can refer you to a financial planner within the organisation or external to the organisation. If you are looking for a deposit product or a transaction account, I can help you there.'

Mr GRIFFIN—And you are saying that is what happens most of the time at banks when that happens?

Mr Thorpe—Very much so. In fact, staff are generally trained to recognise those situations when a person comes in. If they are not looking for a transaction account or a term account but for something more—and there may be other words used such as an interest in shares or whatever—staff recognise those key signs and will refer the people to someone more skilled. Even if you are training people to a full tier 2 level under this particular scheme, it is not going to overcome that problem. They are still not going to be able to give financial planning advice to the customers from behind the counter. Even if you trained them to tier 2 level, the best they can tell you is what their products are about.

Mr GRIFFIN—In terms of incentives offered to counter staff at banks in particular, are you aware of those sorts of incentives that are provided? It could be frequent flier points if you are able to get X number of accounts in a particular manner signed up or it might be a situation of almost a penalty where if you do not meet certain standards in relation to accounts opened then you are in a situation where you go off to a retraining camp. I think that is the term that was used yesterday. I am not fully aware of that sort of stuff, so I have asked the ABA for some more information about where the gulags actually are and how they operate, and whether they are actually gulags. Are you aware of that sort of activity by banks, and can you tell us something about it if you are?

Mr Thorpe—No, I am not. I cannot give you the details of that. I am aware that financial institutions do have some schemes. They may be profit sharing schemes, share schemes and the like which may be summed up at the end of the year and it could be said, 'Yes, you have done very well.'

Mr GRIFFIN—I guess the point we were getting to with that is that we know these schemes are there but we are not quite sure as yet on the detail of what they cover and in what circumstances. But the 'what if' that was asked yesterday was this: if the circumstances are that counter staff can either be rewarded or not penalised if they are able to make a sale at the counter with respect to particular types of accounts and those accounts actually involve something beyond the question of basic transactions, then in effect they have incentive to influence customers to take a particular financial choice. If that is the case—I am not saying it is, but if it is the case—then you have got a situation where, if you like, there is a positive incentive for them to push customers in that direction. There is the question of whether it should happen, but if it is going to happen the issue of making sure people have sufficient training to advise people accordingly is therefore much more important than it would

normally be if that was not occurring or if it was simply incidental to their circumstances. That is the basic tenet of it.

Mr Thorpe—I can understand the sentiment there. I am not aware that it has been identified as a problem area. In reports I have seen and through our own organisation that has never been a concern that has ever been expressed, so I do not believe that is a problem area.

Senator MURRAY—What is your own organisation?

Mr Thorpe—The Australian Finance Conference. If it is identified, quite rightly, by you as being a specific problem then I can understand your concern and it needs specific action. I do not believe that instilling a layer of tier 2 training, tier 1 training or whatever the training prescription is would overcome that problem. If there is a problem that is identified, there needs to be specific action in relation to that problem, and it may already come within the ASIC Act powers of unconscionable, misleading or deceptive conduct. I do not think a training layer would solve that problem.

Mr GRIFFIN—You may well be right. I guess my point is that if that is occurring, if there is an incentive for counter staff to give what is in effect financial advice, then there is an issue about what level of training they actually have. That is a question which goes from it being incidental to there being a situation where it is actually in their interest to do it. That is what I am getting at there. I am not surprised that it has not been identified as a problem by your member organisations because, frankly, if it is going on it is something that they would be encouraging because it is in their interests to flog particular products that they provide. That is understandable. I have no particular problem with that. But if there is an issue with respect to what advice people are getting, that is not something that is likely to come through at that level. The other point I make is that, when a consumer makes a mistake around the question of product selection in the financial services area, quite often it can be quite some time before they realise they have made a mistake, particularly when it is not huge amounts of money. When you are talking about a situation involving interest levels or that is otherwise transaction based in terms of what occurs, it would take some time for that to actually make itself clear, if that is the case. It may not be the case; I do not know.

Mr Thorpe—A couple of points there. One is that the advice I get is not only from the members but from customers as well. I handle a range of complaints that come through in relation to Queensland building societies, which is where I am based. That has never been raised in my 13 or 14 years with them as being a concern.

Secondly, in relation to financial planning, the people at the front counter would not be giving financial planning advice; the only thing they would be giving advice on is those particular products, which we must remember belong to a class of products that is homogenous. We are talking about transaction accounts or deposit accounts. So it is not as though they are saying, 'I will get a commission on shares or managed investment schemes,' or the like. We are talking about giving simple advice on appropriate or available deposit products. That is a very limited class of products.

Mr GRIFFIN—The only point I would make about that is that we were unable to get any firm advice yesterday from the ABA about what actual incentives were being offered for what activities. Therefore, you may well be right that that is all we are talking about here but, from what evidence we had yesterday, that was not shown to be the case. It was not proven not to be the case either; I want to be clear about that. But it was a situation where we said, 'What sorts of recommendations does this cover?' and the response was, 'That is private and confidential to the banks themselves.' The point we made to the ABA yesterday was that it was interesting that they could come along and give us advice about where training is required, when they could not give us advice about what incentives are being provided by banks to their staff around the question of particular products.

Mr BYRNE—To add to what Mr Griffin was saying, the other issue was the one of compliance. We were asking, 'Is this happening?' I think the nub of it is that these people would have an incentive to guide people by not providing alternative advice but saying, 'This is what we are offering; it is pretty good.' When we asked the banks what compliance mechanisms they had to make sure that that was not happening or would not happen, they were not able to answer. We are supposedly waiting for that response at some stage in the next 30 days or so. I think that led a number of committee members to be fairly concerned about the fact that we could identify something but there were no compliance or protective mechanisms set up by the banks. It was in fact the reverse: it was an incentive program where people would be looking for financial advice but the staff's incentive would be to guide them towards these basic products rather than to some other products perhaps. Or that they might, because of the established relationships they had with these individuals, cross over that line and provide some general advice that would then become more specific advice. The question is: how do we know that is not happening? The banking association representative could not answer that.

Mr Thorpe—I cannot add anything further to that other than to say that I feel quite confident that the people at the front counter would not be giving advice outside that particular area of their own products, unless they were trained to do so.

Mr BYRNE—You are saying that you believe that is the case, because that is what customers are telling you, rather than banks: is that right? Are you asserting that because you have evidence from both sides of the fence?

Mr Thorpe—Yes. I certainly would not pretend that it is an area that I have researched. It is something that has popped up. You are not aware of it, I am not aware of it. I understand your potential concern there, and I suppose we can only wait to see whether or not that is a concern. Certainly, from the customer complaints that have come through to me, I can truthfully say that it has never been raised with the Queensland building societies by any customer in the last 14 years.

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

[2.39 p.m.]

McGRATH, Ms Gai Marie, General Counsel and Company Secretary, Perpetual Trustees Australia Limited

SHREEVE, Mr Michael George, National Director, Trustee Corporations Association of Australia

CHAIRMAN—Welcome. The committee prefers all evidence to be given in public but, as you are aware, if you have evidence you wish to give in private, you may request that of the committee and we will consider your request. We have before us your written submission, which we have numbered 6. If there are no alterations or corrections that need to be made to that at this stage, I invite you to make an opening statement.

Ms McGrath—I am here to talk about an area of the FSR which has received probably the least attention but, in some ways, causes a lot of issues for people involved in the trustee industry. That is the requirement to obtain a licence for custodial or depository services. The original requirement to obtain a licence for these services was drafted in a particular way and then changed at a very late stage of the progress of the legislation through parliament. That change was made without any consultation. I think it gives rise to a large number of consequences, which I raise in my submission. These have to be addressed either by way of regulation by Treasury or by ASIC looking at these issues in more detail and providing guidance by way of policy as to how they will operate in the practice of administering trusts.

The particular area that concerns me, which I would like to bring to the committee's attention today, relates to private trust arrangements. The legislation operates so that, if a private trust comes to hold a financial product as part of the trust property and the trustee does that as part of operating a business, they will need to have a licence. It then follows that the requirement to obtain a licence per se should not give rise to too much difficulty for most substantial businesses. However, I think the requirement will extend to many other small businesses and enterprises, such as accounting firms, solicitors firms and others who commonly play the role of trustees for their clients. I think a number of people are unaware that they will need a licence to do the sorts of activities that they have traditionally done for their clients.

If the intention of the legislation is to try to regulate the operation of trusts, then I feel that this legislation is not the right place to do that. Really, parliament should be looking at some form of uniform trustee legislation throughout the country. You may be aware that the Standing Committee of Attorneys-General has been looking at uniform trustee company legislation, and that has been in the pipeline for a number of years. But, in addition to that, we have this general issue about trustees—and trustees can be more than authorised trustee companies, as you know.

If it is correct that parliament intended that the holding of an asset that is a financial product by a trustee should require a licence then, under the FSR, certain things flow

from that. The first requires you to identify a client in relation to that situation, and it is very difficult to know who the client is in the case of a trust. Is it the settlor of the trust, who contributes the assets that lead to the creation of the trust? That is not always the person whose assets they are, because quite often trusts are set up with just $10 being contributed by somebody's friend. Is it the beneficiary of the trust? Is it the person who initiated the creation of the trust? That could be a testator who wants to set up a testamentary trust.

If you can identify the client and say that they are 'retail', the time that you have to give them disclosure, as required by the legislation—like the financial services guide—is not when the trust is created but the first time the financial product comes to be held as a trust asset. In the case of a testamentary trust, the trust is already established and the testator has died at that point, so who do you hand the financial services guide to? And if you do hand it to someone, what does the person do with it? The trust is already created, the fees are already set up and there is nothing they can do—the trust exists. What is the regulatory policy behind trying to capture all these trusts in this legislation? If there was a policy, how can we as trustees comply practically with the legislation and make sure that people involved in these situations are given whatever protection parliament intended? As it exists today, the legislation just does not work in these situations. That is the main point I want to make.

Mr Shreeve—I might just add some points. I am not saying anything different but perhaps just saying it in a different way. I had some discussions with ASIC and Treasury about these areas, and it became apparent that trusts and how they work are not well understood by a range of people. I suppose that showed up with last year's entity tax regulation where we ran into a number of problems. It is fair to say that I have been with the industry for just a bit over a year and in the financial markets all my life, and I did not know how these things worked. In our submission I have tried to outline how trusts work. The sorts of activities we are talking about arguably should never be covered by FSR anyway: writing wills; drawing up a power of attorney; acting under a power of attorney; acting as a guardian for minors, usually under a court order; acting as financial manager for minors and the intellectually disabled, again under a court order; the various types of personal trusts for charities, minors, the intellectually disabled, the intellectually incapable; and discretionary trusts with multiple beneficiaries.

The other thing I would say is that our members are very supportive of regulations to protect consumers. We expect to have no difficulty in receiving an FSRA licence for activities in superannuation and managed funds, financial planning et cetera where we undertake those activities. These remarks are confined to that particular set of activities that I have just outlined.

The first observation I would make is that most of these traditional activities are undertaken by individuals, including legal practitioners and accountants who are already exempted from the FSRA for some activities. Secondly, the arrangements do not contemplate such situations where the beneficiary has no contractual relationship with the service provider. For example, the trustee company is usually acting under instructions from the court or the settlor of the trust. So the beneficiaries may benefit from the trust but they have no contractual relationship with the trustee. In discussions

with ASIC, they cannot think of how they would make it work. How would you handle disclosure or dispute resolution where the beneficiary is unknown, which can happen with charitable trusts or trusts for those not yet born? How would you handle disclosure or dispute resolution where the beneficiary lacks capacity, where they are a minor or a person with an intellectual disability? These activities, we think, should not be covered by FSRA. If they were covered, we cannot see how you could reasonably comply with the requirements. However, in part of these activities—an incidental part, as Gai says—if you acquire a financial asset, then you could be deemed to be covered.

Some other fundamental differences between personal trust activities and what is covered by FSRA are that the trustee is not chosen by the beneficiary; they are chosen by the settlor and, at some stage, the settlor is dead. The payment of the trustee is not determined or paid by the beneficiary; it is paid from trust assets, in accord with the trust deed, the law and sometimes a court order. Instructions to the trustee do not come from the beneficiary; they come from the deed, the law and the trustee's own judgment. The trustee cannot be removed by the beneficiary. That requires the trustee's agreement or a court order. The other point is that the legislation that underlies trustee corporations' activities is currently being rewritten. Uniform trustee companies legislation has been around for a while, but we do not believe that a sensible regulatory framework can be established for these unique activities until the underlying legislation is settled.

Our suggestion is that the regulation of these activities should remain with the state and territory governments for the time being. As this new uniform legislation is being crafted, it should have regard to the ASIC and APRA regulatory frameworks and, where sensible, be harmonised. Once that legislation and regulatory framework is settled, then it might make sense to see if it can somehow slot in with the FSRA and ASIC framework. But to try and do it right now when the underlying legislative framework is being reassessed, when there are no practical ways we can see of making it work, does not make sense. We think it does not make sense to put it in that framework.

We also note that, as well as accountants and legal practitioners being exempted for some sorts of activities, the act does provide for the public trust offices to be exempted by regulation, although the regulation has not yet been issued. Trustee corporations are of two populations, with those public trust offices owned by state and territory governments, and there are private trustee corporations such as Perpetual. So our suggestion is that that regulation be issued and that it also be extended to private statutory trustee corporations where they do the same activities.

CHAIRMAN—To clarify your concerns, firstly, an organisation like Perpetual Trustees Australia Limited, which acts as trustee for a number of large and small trusts—including family trusts, testamentary trusts and so on—will be required to be licensed because it is obviously in the business of providing trustee services.

Ms McGrath—Absolutely. For historical reasons, we have individual companies in each and every state and territory. That is how it was built up; we have been around

for over a hundred years. So it would require each and every one of those companies to hold a licence separately for those activities.

CHAIRMAN—Am I also accurate in interpreting what you are saying as going further than that, in that you are saying that even private family arrangements might get caught? For example, if a family had several trusts and just used one company as the trustee for all of those trusts, that company—even though it was a family company that took no fees or whatever—could be required to have a licence?

Ms McGrath—It could be required to, yes.

CHAIRMAN—How great a likelihood is that?

Ms McGrath—It depends on the individual circumstances. There is no definition of 'carrying on a business' in the legislation, so you rely on the general case law on that topic. You do not have to have a profit motive to be carrying on a business. It could involve an element of repetition. You could do it once and be seen to be carrying on a business. There are a whole range of other sorts of activities, like the running of an employee share plan by a company. That will probably require a financial services licence. I do not think a lot of people realise that, because of how broadly this has been drafted.

CHAIRMAN—You have raised this issue with Treasury and they have declined to amend the regulations to remove what you see as the problem. Have they reacted? What has been their response when you have raised issues like that?

Ms McGrath—Maybe they did not fully understand the issue, but they were not able to particularly articulate the policy reason why this has been drafted the way it has been drafted. We were asking, 'What are you trying to cover? What sorts of protections are you trying to give to these people and who are the people you are trying to protect?' They were not able to articulate those issues. I think maybe what happened is that, in the lead-up to 11 March, it just became too big an issue for them to deal with. ASIC are similarly struggling with the issue and have issued no statements or guidance on this area at all.

Mr Shreeve—I think that is probably fair. I think it is a genuine misunderstanding. The first draft of the legislation said that public trust companies would be exempted. Then in April last year it said that they would be exempted provided a regulation were issued—words to that effect. There has been no more movement on it. I think it is a tricky issue to explain. This area has been handled by state and territory governments, so the Treasury people do not get involved in personal trust activities. I personally think it is just that, having no background experience in it, everyone is lining up at the door saying, 'We want an exemption, we want an exemption.' With this one, because they did not realistically understand it, because they had not been exposed to it before, they probably did not look at it and just left it there. I think it is fair to say that we have probably explained the issues better in these submissions than we have done previously. That is my feeling. Maybe we did not do as good a job as we could have in explaining it to them.

CHAIRMAN—Are there further questions?

Senator MURRAY—Yes. Although it is on the record elsewhere, I ought to declare an interest in that I have a family trust and my own super fund. My ears pricked up. It would seem to me that one protection would simply be to exempt any trustee unless they were providing financial advice. Why would that not work?

Ms McGrath—That is how it was originally drafted. It said, 'If you provide this service in conjunction with another financial service, such as advice, dealing or other activities that require a licence, yes, you will need to get a licence.' That is how it was originally drafted, then that was completely replaced. They took out the bit about the other service, the linkage between the two services.

Senator MURRAY—As someone who has been embedded in this whole process from whoa to go, as have other members of the committee, I know that the intent was to deal with financial advice, not to catch anyone who is not giving financial advice.

Ms McGrath—Exactly. We are going to be licensed for all of those activities, and we do not have any difficulty with that at all.

Senator MURRAY—On the second issue you raise, the simplest and most common form of trust structure for small operators is indeed a corporate entity, an incorporated body—the trustee—which has no income and no expenditure. It is simply the holding device for the trustee function. Then you have the superannuation fund, the family trust or whatever it is, beneath it. I would think there is a second form of exemption which is easy to make. In those circumstances, the trustee is providing financial advice to the beneficiaries; however, they are often one and the same. Generally speaking, the entity that is holding the corporate entity is the trustees, who are also involved in the family trust or the superannuation fund. So, once again, I would suggest that an easy exemption is where the trustee is the same as the beneficiary, who has no need to hold a licence and ought to be advising itself, even though it is in two separate dealing personas.

Ms McGrath—Two capacities, yes. It does not make sense.

Senator MURRAY—It makes no sense. I would have thought that is a fairly commonsense issue to get across. I would think you are talking about large numbers of people. From memory, there are about 200,000-odd small superannuation funds, and nearly all of them have the kind of structure I have outlined. Generally speaking—take it away from my own circumstance to, say, somebody who owns a chemist—dad perhaps owns a chemist, mum and dad are the trustees and mum and dad and the kids are the beneficiaries. I cannot see that you would want them to be licensed and all that.

CHAIRMAN—Not if the cost is $25,000!

Ms McGrath—That is right. There is an exemption for running a superannuation fund if you are your own trustee of the fund but, as you said, if you also have a family trust in conjunction with that, there is no exemption for that part of it.

Senator MURRAY—That is right.

Ms McGrath—It seems a bit strange. They exempt it. You are running your own super fund; you do not need a licence to do that. Why didn't they exempt this other area as well? Then you have all the areas where we operate for people with no capacity. How do you operate this regime in that context? These people do not have capacity. They cannot make decisions and they cannot make choices. That is why we are there—to protect them. You cannot give them a financial services guide; it means nothing to require us to do that.

Mr Shreeve—Indeed, the trustee does not provide the advice. The trustee has full responsibility for doing what it thinks is appropriate. It does not say to the beneficiary, 'I think we should do this. What you think?' It may take into account beneficiaries' thoughts and activities but, really, the trustee is charged with doing what it thinks is appropriate.

Senator MURRAY—I would be reluctant, personally, to go down that route. I would much prefer to say that trustees are exempt unless they provide financial advice, then you cover the field, or unless the person to whom they are providing financial advice is also the same individual—there is a legal term for it—as the two separate legal identities.

Ms McGrath—Different capacity.

Mr Shreeve—Would that cover being a guardian and those types of things?

Ms McGrath—There is not financial advice given in that situation.

Mr Shreeve—No, there is not. That is right.

Ms McGrath—The trustee makes the decisions. It is subject to the prudent person rules in all the trustee acts, and must make decisions in the interests of the beneficiary. Advice is not being given because the trustee makes the decisions. It is not advising anybody; it is doing it itself. Where the advice comes in is the point in time where you might be establishing a trust and you would be giving advice to retail customers about how you set up your financial affairs, how you plan your estate and all those things. That is the time when all this regulation is entirely appropriate.

Senator MURRAY—Yes, that is what we are trying to get at. For me, you make a valid case.

CHAIRMAN—As there are no further questions, thank you for appearing before the committee again.

[3.00 p.m.]

HANKS, Mr John Anthony, Consultant, National Insurance Brokers Association of Australia

PETTERSEN, Mr Noel, Chief Executive Officer, National Insurance Brokers Association of Australia

CHAIRMAN—Welcome. The committee prefers all evidence to be given in public, but if at any time you wish to give evidence in private please request that of the committee and we will consider such a request. We have before us your submission, which we have numbered 33. Are there any alterations or additions you wish to make to the submission? If not, I will ask you to make an opening statement, at the conclusion of which we will proceed to questions.

Mr Pettersen—It is pretty much as read, in terms of the submission. Before we address some of the things that we have put forward in the submission, let me say by way of a general statement that, in terms of the Financial Services Reform Bill, this is something about which, as an association, we represent insurance brokers who, by law under the current Insurance (Agents and Brokers) Act, are required to act on behalf of the insurance buyer and not the seller. In terms of the agents and brokers act, we have had legislation in place for almost 15 years now and it has worked well. Over the past four or five years, as we have gone through the CLERP process into now FSR, a lot of what we have seen in the legislation has been, hopefully, part of harmonisation of things that have worked well under the old regime with the new regime. We did have an act of parliament that effectively protected consumers dealing with registered insurance brokers.

Certainly, throughout the process, we have chosen to work alongside the regulators in ensuring that we get laws and regulations that are workable. I would think that we could say that probably 90 per cent of what we see on the table these days is, in fact, legislation that we deem to be workable and deem to be harmonisation of those things under the old legislation that are now within the new legislation. However, there are a number of things that are not, and we will talk about those in a moment.

In terms of bringing our members up to speed with the new requirements, it is important that the committee hears about some of the positive steps that we as an association and certainly our industry have taken to make sure that we hit the ground running with the new regime. Effectively, we have been working with our members for some time to make sure that they can comply, especially in terms of education and training. So much so, that last October, as an association, we committed member funds to ensure that all our members, all our member brokers and all our licensees and authorised representatives, would, in fact, fulfil the requirements of PS146 in terms of skills knowledge. We committed funds to ensure that they all undertook assessments of their skills knowledge and experience in line with industry requirements. That was, effectively, a $1 million commitment out of industry funds paying for those 1,000 or so—probably closer to 2,000—authorised representatives and brokers within the

organisation. It has certainly been a step which has shown that we have embraced change and are moving forward in a very positive way.

We are here today because a number of things in the agents and brokers act have not been replicated under the new regime. We feel that, in the interests of consumer protection, they certainly should. They are simple things yet, at the end of the day, they would bring about an act that is a lot more workable. We support the thrust of the act. However, some of the things under the financial services reform arrangements have been left aside. These are basically warnings in relation to dealing with an unauthorised foreign insurer, providing details of the insurer with whom the broker is dealing and the client is contracted, and also disclosing various associations with insurers and disclosing binder arrangements with insurers.

We also say that ASIC should be empowered to collect statistical information about licensees dealing with unauthorised foreign insurers, as they are currently able to do under the present legislation. Changes along these lines will ensure that wholesale general insurance clients of financial service licensees are better informed and better able to make decisions about where their insurance should be placed without adding to the licensee's costs. The changes would also mean that appropriate statistical collections continue to be made.

CHAIRMAN—Thank you. Have you raised these issues with Treasury?

Mr Hanks—Yes, we have. Initially we raised it some 12 months ago. At that stage the view was that they did not see a need at that particular time. The issue is that a number of things in the agents and brokers act apply to both wholesale and retail.

CHAIRMAN—Yes, I understand that.

Mr Hanks—The initial view by Treasury was that they did not want to introduce any requirements whatsoever in relation to wholesale, that people were big enough to look after themselves. So initially we did not get a positive response. We raised it more recently with both ASIC and Treasury. Particularly in relation to the unauthorised foreign insurer, they became very much more aware of the sorts of things that we are talking about. You do not have to be a very large player to be classified as a wholesale person purchasing insurance. The purchasing of a house, a car and travel are considered retail insurances. All other things are outside that and are classified as wholesale. A small businessman insuring his own property or his liability would be classified as wholesale.

CHAIRMAN—Or a farmer getting crop insurance?

Mr Hanks—Exactly. That is wholesale.

CHAIRMAN—Stock insurance?

Mr Hanks—Exactly. This is obviously different from the sorts of situations where you have large wholesale people in the financial world where the test is on their net worth. At the present time there is a difficult insurance market. People are being

forced to look overseas for their insurances because they just cannot buy in Australia: it is difficult or the price is not right. We are seeing more and more people looking at purchasing insurance overseas. Under the agents and brokers act there is a requirement that those people receive a notice and acknowledge receipt of the notice saying that the insurance is being placed with an unauthorised foreign insurer and that it is not subject to Australian regulation in any way. It is up to them to make relevant inquiries about where the insurer's business is operated, whether there is regulation applying in that domicile and the capital of the insurance company. There is a clear warning. Without that clear warning, and in the present market where people are moving towards more reliance on overseas insurance, we are concerned that there are going to be situations where they do not go in with their eyes fully open.

We have seen a number of companies that have collapsed operating in the Australian market as foreign unauthorised insurers. We have seen in recent times both ASIC and APRA issue warnings about this sort of thing, but here we have a situation where you only have household, car insurance and these sorts of things. These are not the insurances that people are going overseas to purchase.

Mr GRIFFIN—Are they unauthorised because they have not sought authorisation in Australia or because they tend to be unsuitable?

Mr Hanks—Largely, there is a combination of all sorts of things. They are unauthorised to conduct business in Australia. They can, however, conduct business in Australia through an agent. Some of them are obviously reputable companies. Insurance is an international market and not all unauthorised foreign insurers are fly-by-nighters by any stretch of the imagination. However, some of those established in the Cayman Islands or the Solomons are doing so with a relatively small amount of capital. Either they cannot meet the Australian prudential requirements or they do not wish to meet them. We have had some situations recently in which APRA tightened up its regulations, as you are aware. In that process, some people lost their authorisation to conduct insurance business in Australia. What will they do? APRA has in fact said that they could turn around and be agents for somebody else. I will read from APRA's recent release when they were releasing notification of those companies that are authorised to conduct business under the new regime. It says:

> In some cases, the brand name of the revoked insurer may continue to exist in relation to its business as an insurance agent, broker or underwriting agent for other general insurers.

So you have a situation in which this company is no longer authorised but it is difficult for people to understand that it has not been authorised.

Mr GRIFFIN—On that example, let us say it is Bloggs Insurance. Since the change in rules, Bloggs Insurance is no longer authorised. Could Bloggs Insurance become an agent for QBE or whatever—

Mr Hanks—Yes.

Mr GRIFFIN—but still operate as Bloggs Insurance selling QBE product?

Mr Hanks—Exactly. That is one of the other things we want to clarify. Under the Insurance (Agents and Brokers) Act, there is an obligation on the licensee or the intermediary to clearly state who the underwriter is and their place of address. So, in this situation, the intermediary should be clearly saying, 'It's not Bloggs but it's QBE' or whoever. Similarly, we believe that where you have insurers and their intermediaries, the intermediaries acting under a binder for an insurance company—that is, it is able to bind the insurance company—are acting as the insurance company's agent and are not independent. We believe that those situations should clearly be disclosed for the benefit of the insured. Similarly, any association with the insurer should be disclosed.

Mr GRIFFIN—You were saying you had had a better reaction recently on the wholesale issue from Treasury and ASIC.

Mr Hanks—Yes.

Mr GRIFFIN—How much better?

Mr Hanks—Much better. We mentioned to them our intention of putting forward a submission, and it was received. They said, 'Yes, we'd be happy to see that,' and we have copied the submission so they are aware of the general thrust of the issue. I believe they now see some difference between risk insurance when you are getting into the wholesale area and other financial products and that it is worthy of drawing that sort of distinction between risk products. There may not be a need for wholesale requirements in other areas, but I believe that that is a different situation in relation to risk insurance.

CHAIRMAN—If I can draw a parallel, what you are asking for are the same provisions to apply in the FSR Act as apply, for instance, in the Trade Practices Act.

Mr Pettersen—The current agents—

CHAIRMAN—That is more specific, but drawing a wider circle small business, in this instance, can be regarded as a consumer in certain areas.

Mr Hanks—We are happy with the definition of 'retail' and do not want to change the definition. We are quite content with that definition. We are saying that these are not really detailed selling requirements, but there are some basic disclosures that operate between the intermediary and the insured about the insured that should be disclosed. If they were disclosed the market would be better informed and the insurance buyer would have better protections.

Senator MURRAY—Are statistics available which you could provide to the committee which show the total amount written of insurance on retail versus wholesale and what percentage of wholesale or volume—I do not know how your statistics are done—is done offshore? That would give us an idea of the quantum affected.

Mr Hanks—Obviously, through the APRA statistics, it is possible to look at car insurance et cetera. We could make some general statements about how much is retail and how much is wholesale.

CHAIRMAN—You also need to draw a distinction with the wholesale segment, do you not? What you are really concerned about is small business.

Mr Hanks—Not really. If you have house insurance it is classified as a retail product, whether it is a $10 million house or a $100,000 house. House insurance is retail. It is the same with car insurance. There are some classes of insurance that we could go to and say, 'In all these classes, this is the amount of business, so this is the amount of retail.' We could add them up and say, 'This amount is retail, this amount is wholesale.'

CHAIRMAN—I am trying to get clear in my mind what you are actually referring to. Wholesale would include General Motors getting its insurance too, wouldn't it?

Mr Hanks—Exactly.

CHAIRMAN—Whereas what you are really concerned about is the small businessman getting the proper protection rather than, for example, General Motors. Or do you want the whole range?

Mr Hanks—We go back to where we came from in getting the definition of 'retail' for general insurance. The idea of having net worth, as I mentioned before, is not a very attractive definition for risk insurance. Nobody is concerned about only insuring the part of the house that they own, not the part that is mortgaged. You insure the total house. It is the total value of the assets with which you are concerned, not how they are financed or anything else.

Senator MURRAY—I think you misunderstand what the chair is saying. He is saying that Treasury says, 'Those in wholesale are big enough and ugly enough to look after themselves.' We would probably accept that a very large corporation that shops for its insurance offshore could make a judgment themselves. They are sophisticated and large enough to do that. The chair is asking: if the farmer or the small business owner or the shopkeeper buys offshore insurance, how big is that?

CHAIRMAN—Yes, that segment as distinct from the whole wholesale market, which would include General Motors and Westpac et cetera.

Mr Hanks—I understand. The point I was trying to make was that it does not matter how big the person is, house insurance is retail.

CHAIRMAN—I understand that. I understand the distinction between retail and wholesale. It is just within this wholesale segment—

Mr Hanks—It is difficult then to try and make judgments about how you go about adding that other section in and so on. Basically, we are content with the definition, as it is, of 'retail'.

Senator MURRAY—You are presenting us with a problem. You are saying that here is a problem we should be concerned about. Notionally, in my head is that somewhere in the Cayman Islands there is a scam outfit which is selling people insurance and has no intention whatsoever of ever paying up. They are not properly regulated, and that is a worry. If we were able to know from you that the total amount of insurance written offshore was such and such in poorly regulated markets as opposed to, say, the United Kingdom, which is probably well regulated, we could get a feeling as to the size of the problem and whether we should be taking this issue that you present to us seriously.

Mr Hanks—The other half of our submission is in fact suggesting that this sort of information be collected—that the statistics be collected.

Mr GRIFFIN—You are saying the statistics are not there at the moment?

Mr Hanks—The information is in fact being collected at the present time—

Mr GRIFFIN—But not evaluated?

Mr Hanks—because all insurance brokers or any person—

Mr GRIFFIN—In your experience, do you think that it is a significant issue?

Mr Hanks—It certainly is a significant issue at the present time.

Mr GRIFFIN—Could you give me a ballpark figure as to the size of the wholesale market we are talking about?

Mr Pettersen—Could I just jump in there and talk about the people we represent. Brokers probably write about $6 billion worth of business in Australia. There is the very top end, the Marshes and the Aons—the multinational companies—and there is the long tail. Predominantly, I would think, 80 per cent of our membership would be small business operators with probably less than 10 staff. The percentage of the business that they write at the small business or commercial end would be 70 per cent or 80 per cent. That is predominantly in the SME area.

Mr GRIFFIN—We are really looking at the unauthorised foreign insurers, who I take it are not among your members. Do you have any idea, any feeling on how big their market is at the bottom end?

CHAIRMAN—None of the insurers are members; these are the brokers.

Mr Hanks—This business is being placed by brokers or by agents, and some goes direct. We do not have good figures on it at the present time. Some information is

collected by bond brokers and from agents. That sort of information is not collated at the present time or published by APRA, but it is submitted as part of the Insurance (Agents and Brokers) Act. The sorts of figures there are that about 15 per cent of the market is currently being placed overseas.

Senator MURRAY—Of the wholesale market?

Mr Hanks—Of the total insurance market to unauthorised foreign insurers. For example, Lloyd's would be authorised, and it would not matter whether or not it went direct to Lloyd's in London. So it is something in that order, but we do not get published figures on it on a regular basis and we do not have any information in respect of people who place the business themselves directly overseas.

Mr GRIFFIN—It is not inconsequential, though, from what you are saying.

Mr Hanks—It is not inconsequential, and at the present time there is a real issue.

Mr GRIFFIN—It is growing?

Mr Hanks—It is growing. The simple thing is to continue what we already have. It is a pretty simple thing for the intermediary to supply this information. Brokers are happy to continue to do it. They have been doing it for 15 to 20 years so they do not see it as a big issue, but if they see that others who are not brokers or who are not part of NIBA do not need to do this, then that is where the problem will come from. We can see the problem coming before us, because more business is going overseas at the moment.

CHAIRMAN—Basically, what you want is for the protections that are currently in the Insurance (Agents and Brokers) Act to be translated into FSR, and that would fix the problem.

Mr Hanks—Exactly. That fixes it.

CHAIRMAN—That would then apply across the board, whether the wholesale client was the farmer or the shopkeeper at one end, or General Motors or Westpac at the other.

Mr Hanks—Yes, as they do presently.

Mr GRIFFIN—Following on from that: because you believe the problem is anecdotally growing and, as the statistical information is already being gathered, you believe that information should be collected and analysed.

Mr Hanks—Exactly, so it would be available to the committee or anybody else who wants to look at it.

Mr BYRNE—But it is not fixing the problem. You are just identifying the scope of the problem rather than fixing the problem, aren't you?

Mr Hanks—I think disclosure is a big answer, the biggest answer. If people understand who they are dealing with when they are placing business overseas—if they are aware of the facts—then they can take whatever decisions they want to. We do not want to stop people from going overseas, because we live in a world insurance market, and that would not be sensible. So it is warning those people, particularly those who may be not quite as sophisticated, about the risks that they are running and that they should make some sensible inquiries.

Senator MURRAY—Can I interrupt briefly here? I think it is more than a disclosure problem, if I may say so, but I would like to get your answer. There are many circumstances in business, whether it is farming, shopkeeping or manufacturing, where the obligation to insure is imposed on you by contract and the person being insured does not really care. Provided they can show the land-holder or whoever it is the invoice, they have fulfilled their side of the bargain. If somebody were insuring with, say, an unregulated market—and I will use the Cayman Islands as an example because I just do not know—and then there is an insurance event and claims are made and they do not pay up, as far as the person who bought the insurance is concerned, they might have fulfilled their deal and the fact that the shopping centre has burnt down is irrelevant to them. As I see it, it is not just an issue of disclosing the fact that you are dealing with someone who is not authorised under Australian law but you may be dealing in a market which is not regulated. I would be comfortable if someone were dealing in the UK, the USA or whatever because I assume they are regulated markets.

Mr Hanks—I agree with what you are saying. There are possibly some ways in which you could overcome that by stating that if you were a bank you would want an insurer who was authorised in Australia or had some other criteria so that the person taking out the insurance had to meet certain obligations in relation to that insurance. There are obvious risks when people go overseas. At the present time, it is handled by disclosure, and it is accepted that there may be other ways of dealing with it in addition to disclosure. But, at the present time, as I said, we do have disclosure but when we move to FSR we will not even have disclosure.

Mr Pettersen—It does have the potential, given that there is more insurance now in a contracting market, of being pushed offshore, some of which would be in very strange places. The circumstance which you have identified is correct. The test of any insurance policy comes when you make a claim, and this does have the potential to come back and bite. Under the current legislation, at the very least, the buyer of insurance is being warned about where this insurance is going and where it is being placed. Yes, if they want any insurance at all, at the end of the day they do have to assume some of the risk if it is going to be placed in the Cayman Islands or wherever. Our submission is that, at the very least, the facility to warn the buyer of insurance should be included, whoever the buyer is, be they a wholesale client or a retail client, under the new regime as well.

Senator MURRAY—My concern, and the reason I went that way—and I assume your reaction had this at its heart—is that, where it is in a person's self-interest to insure, they are more likely to be conscious of the disclosure. When it is in their self-interest to insure at the lowest possible cost to meet a contractual obligation, they may

well go to a fly-by-nighter. The Australian regulation seeks to avoid that situation, but the Cayman Islands, for example, might not.

CHAIRMAN—In those instances, doesn't the person responsible for taking the insurance have to advise the other party to the contract where their insurance is placed?

Senator MURRAY—They may, but—

CHAIRMAN—And it has to be approved by them normally.

Senator MURRAY—it may be a relatively unsophisticated example. Let us use the shopping centre example: an immigrant has come to this country, worked hard, saved his money and bought a little shopping centre of eight shops. That person would have a standard agreement that every member of the shops must have bought insurance. That kind of head contractor would not necessarily have the sophistication to judge that.

Mr BYRNE—I will add to Senator Murray's point. How are they warned? What is the mechanism? Is it a document? Is it verbal advice?

Mr Hanks—Under the Insurance (Agents and Brokers) Act there is a document proclaimed by regulation that says what you have to notify. It is signed by the buyer of the insurance to indicate that they have read it and that they understand it.

Mr BYRNE—So it would be one of those three-or four-page things where they sign fairly quickly. I am not meaning to be disparaging—

Mr Hanks—Yes, that is true.

CHAIRMAN—It has worked satisfactorily under the existing legislation.

Mr Pettersen—I disagree, because I think the obligation is on the broker, that they have a duty of care on behalf of their client. If they are dealing with an unauthorised foreign insurer, they would make it clear to your greengrocer with his shops, 'This is where your policy is being placed, for this reason.' In most cases it is the last resort because they cannot get it anywhere else.

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

[3.32 p.m.]

BAKER, Mr Charles Bruce, President, Boutique Financial Planning Principals Group Inc.

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public but if at any time you wish to give evidence in private you may request that of the committee and we will consider such a request. We have before us your written submission, which we have numbered 24. Are there any additions or alterations that you need to make to the submission?

Mr Baker—We have sent an additional letter to the committee, which hopefully you have got as well.

CHAIRMAN—We will receive that as an additional submission. There are no other alterations?

Mr Baker—No.

CHAIRMAN—I invite you to address the committee, at the conclusion of which we will ask some questions.

Mr Baker—Thank you. As president of the small dealers association, my objective today is to do two things: to give you some feedback on the ever-increasing compliance burden for small businesses, which is obviously a major burden, and I am sure you are all aware of that; and to present the case as to why you should be supporting small dealers rather than trying to do what feels like kill us off sometimes with the compliance burden. I do not want to just talk about problems today; I also want to talk about an alternative solution that I believe ought to be considered. In the letter that we forwarded on to Bronwyn Meredith a few days ago, we put the case about why small dealers are an important part of consumer choice. At a time when large fund managers are increasing their ownership of financial planning businesses, small dealers are mainly independently owned businesses and we do not face the same conflict of interest as financial planning subsidiaries of large fund managers. This increases the chance of unbiased advice from these small, independently owned businesses. So small dealers are an important part of consumer choice, and that is really the point that the Consumers Association was making in this article which I also circulated a few days ago.

Secondly, independently owned financial planning businesses are an important part of consumer protection, I believe. For example, if a fund manager misbehaves or behaves in a way which is against the best interests of investors, an independently owned financial planning business is likely to take action against the fund manager, for example by referring them to the regulator. By contrast, is it really likely that a financial planning subsidiary of a large fund manager would report the parent company to the regulator? My first appointment here was with APRA over such an issue.

Let us move on to the compliance issue in general and FSRA and policy statements in particular. Let me give you some background so I can paint you a picture of small businesses in this arena. My business is one of the businesses, obviously, that my association represents. It is a small business. I am the only adviser. I have got two part-time assistants. One has been with me for two years; another, whom we are still training, has been with me for four months. My wife helps with the accounts and administration. To state the bald fact, the compliance burden for small dealers over the last few years has been pretty dramatic.

Regardless of the philosophical arguments for and against the GST, it has been a major compliance burden, both in gearing up for it and in ongoing administration. Other compliance impacts have been the privacy law; some of the small businesses have been affected by alienation of personal services income. Now we have got a massive round of new changes here with the FSRA and also the related policy statements. To complicate matters, our own professional organisation, the Financial Planning Association, has added an extra layer of compliance on top of this.

To date the voice of small dealers has not been heard, because we have been flat out running our own small businesses. As you can imagine, with the size of a business like mine, we just have not got time to go and speak to groups like yours very often. With the immensity of this compliance burden ahead of us, at this point in time, collectively, we feel that we have got no choice but to take a stand and speak out. Trying to keep abreast of the changing rules is, by itself, a major task. The FSRA and related documents and the policy statements and so on sit about this high on a desk, so just reading those alone is a mammoth job in itself. Of course, then you have got the ongoing administration.

However, our first job is to understand what is required of us under the new rules and, as small dealers, we are determined to find a way of complying, regardless of the burden. We can see through all this documentation which ASIC has provided us with what a large dealer needs to do to comply, because it is spelt out in great detail. But as small dealers we are told by ASIC that we do not need to go as far as large dealers. It would not be possible to do so anyhow. I am going to try to point out some areas to illustrate the vagueness in the policy statements and to get you to see what we as small dealers are trying to grapple with. PS164.8 states:

> What an individual licensee needs to do to comply with the law will generally vary according to the nature, scale and complexity of the business.

The question is: what exactly does that mean? To start clarifying this question, as a small dealer association, we have been embarking on a process to try to properly understand this question from a small dealer's perspective. A few weeks ago, we had a useful session with Pauline Vamos from ASIC. Pauline indicated that ASIC want us to do what we think is appropriate so that we are confident that we are complying. Pauline indicated that ASIC does not need massive compliance policies and procedures manuals from us. What they want is that, if someone asks us what we are doing to comply with XYZ, we can tell them what we are doing to comply with those things. We came away from that meeting with Pauline having the feeling that we

might be able to find with ASIC a sensible and practical way for small dealers to comply.

However, the vagueness of what is required creates a few interesting scenarios. For example, what if someone else in ASIC has a different interpretation from what Pauline Vamos has, or what if the person who takes over from Pauline Vamos has a different interpretation? What I am trying to do is create a picture of business uncertainty, business risk, compliance risk for small dealers and so on. How can we be sure that we have done enough to comply? The rule book is so big that the risk that some rule may be overlooked is significant. But the vagueness of rules is an extra challenge. I will illustrate what I mean by this in a minute.

There are other consequences. Let us consider this situation: a few weeks ago a small dealer was audited by the Financial Planning Association. It was a business with one planner and a few support staff like mine. He was rapped over the knuckles for not having written procedures for minor things like how you open the mail. This is what is going on out there. A lot of people out there are going around and saying that we need written procedures for small business for things down to that level, because of these policy statements. That is what he was told by the FPA. We asked Pauline Vamos about that and, pleasantly and pleasingly, she said that this was absolutely not required. But this told us a few things.

Senator MURRAY—It says something about the FPA.

Mr Baker—That is a point too. But it says that ASIC may have a practical and sensible approach for small dealers and that the FPA may be imposing some unnecessary extra burdens on small dealers by using FSRA and ASIC policy statements as whipping sticks. It also tells us about the opportunity for misinterpretation of the new rules. PS164.15 says:

> We expect licensees will have in place processes and procedures to ensure compliance...In most cases, they will be documented in some form. We expect that licensees will have in place monitoring and reporting processes...In our view, it is more difficult to show compliance where documentation is not in place.

If we do not need compliance procedures for opening the mail, which things do we need procedures for? The bottom line, as a small dealer association, is that we have a fair way to go to understand what is required of us. To their credit, ASIC, through Pauline Vamos, is indicating a willingness to help us to find a sensible and practical approach to compliance. The situation is creating a fair bit of business uncertainty for us. We have got a situation where vendors of compliance services are running around peddling their wares using fear and uncertainty to pressure small dealers into buying their services. As small dealers, we are looking for a few different things if we can. We are looking for some sensitivity to the burden of compliance that small businesses are carrying. At the end of the day, the costs are passed on to the consumer. In the meantime, this compliance burden may kill off small businesses and discourage others from starting up.

We would also like greater business certainty as to what the rules actually mean. What actually is the right interpretation of these new rules? We also think it is worthwhile that an audit of the rules is desirable so that we can ensure that each

aspect of the compliance really does deliver a benefit to the consumer at a reasonable cost. A consumer does need small dealers as part of choice. I believe the government and the regulators need us, as small dealers, as an important part of consumer protection. We actually need your support for independently owned security dealers and AFS licensees. I believe this group does represent more closely the objectives of the government and the Australian Consumers Association as far as what they are seeking for consumers.

Rather than just leave you with the problem, let me move forward and try and explain perhaps what one of the solutions might be. This is a difficult problem and trying to find a good result for consumers is not an easy problem to deal with. Let me start with a quote from Ross Buckley, director at Bond University, in today's *Financial Review*. He was talking about the shenanigans going on at the moment in the United States and in the corporate world. His comment is:

No degree of regulation can force people to be honest.

This is the same point that was being made in this article that I forwarded to you from Tom Collins. There is a problem with the approach that is being adopted at the moment. There is perhaps a naive view that if we add more and more compliance and more rules, we will get a better result for consumers. I believe that that is an assumption—probably an untested assumption. If we apply lateral thinking, we can perhaps look at different ways of solving this problem.

Let us come at this problem from this perspective: what is the outcome we seek? The outcome we are seeking is a better outcome for the consumer. What is proposed currently is the strategy to achieve that result. At the moment we are looking at an onerous compliance regime as being the strategy to achieve that result. With this compliance regime the regulator hopes to get a better outcome. They are hoping, I believe, to get a better outcome. But rather than going down the path where you hope to get a better outcome, why don't we go for the jugular—go for the goal we are really looking for and test outcomes?

I will give you an example of testing outcomes: once a year every dealer, every licensee with ASIC, gives ASIC a list of all the people they have provided advice to over the last year and once a year ASIC samples a couple of people that have received advice from each dealer. The people who are receiving that advice know whether they are getting crap or whether they are being ripped off. The consumer is the one who knows. They are the people who should be asked. They are people who will tell the regulator where the problem is. If you really want to get rid of the problem and you want to get rid of the problem quickly, that is the way you have got to solve the problem. You have got to look at outcomes. Find where dishonesty is happening and remove those people who are dishonest from the industry. Just adding more rules will not legislate for honesty. That is not an approach that will achieve that outcome if that is the goal which is sought.

Mr GRIFFIN—If you are in a situation where you are saying that the consumer knows, then is there really a need to audit? If the consumer knows, surely they will complain.

Mr Baker—I think that there are a lot of consumers who know there is a problem but do not complain. In fact, I think it is a fairly widely viewed thing that, for every voice that is heard, there are probably 100 voices out there which have not spoken up. I think this is a way in which ASIC could actually test what is happening with each dealer as well.

Mr GRIFFIN—I do not think it is that high a percentage when people are being ripped off.

Mr Baker—I think there is a range of problems out there. One is where people are being ripped off and one is where less than good practices are being carried out. It depends how far you want to go. Ideally, we should be trying to identify problems early and root those out as quickly as we can and do so, hopefully, at a minimum cost to the community and to everybody out there. The advantage of the sort of approach that I am suggesting is, I believe, that you can get the right sort of result much more quickly. You do not add nearly so much cost to the consumer—because, at the end of the day, they are the ones who are going to bear it—and you do not have so much collateral damage. For example, you are not going to kill off so many small dealers or small businesses along the way, who are actually employing a fair few people, and you give a fair go to these small businesses. I believe, in the end result, the consumer wins by this approach—that is the key point. If you consider these sorts of lateral solutions, we will get a better result, less damage and greater certainty of the outcomes.

CHAIRMAN—It seems to me that the sorts of issues you have raised and the problems you have identified are similar to some of the evidence we have heard from the Association of Financial Advisers representatives, Michael Murphy and Dugald Mitchell. Are you familiar with the evidence they gave us?

Mr Baker—No, I am not.

CHAIRMAN—They have raised some other issues as well, but some of the issues you have raised are similar to the ones they raised. Is this an issue that you think can be dealt with through the regulations and the policy statements attached to the FSR Act? Or do we need to go back to square one with the act and change the legislation to solve some of these problems?

Mr Baker—I was offering an alternative solution. I wanted to come down here today and not just present the problem to you. It is really only in the last week that I have started wondering how I could put a more positive solution for this rather than just giving you the problem. I would like to present this as a style of approach whereby I think you could have wins all over the place. If the consumer wins, we end up with a healthier industry with more choice. It is too easy to adopt the bureaucratic approach because it is easier to create rules and it sounds and feels like it is going to get a better result. But a lot of people have the view, like this guy from Bond University, that that approach just cannot work, at the end of the day.

CHAIRMAN—You are characterising the current approach as the bureaucratic approach.

Mr Baker—It is.

CHAIRMAN—So, obviously, to move away from that to your approach does require some changes to the regulations that have been formulated, I would expect, or even to the legislation.

Mr Baker—Or at least changes to the policy statements. Let me not portray myself as an expert in everything that is there, because it is so thick that we are still trying to wade through it. If we were going to massage what is there, I do not know whether we should just massage the policy statements, which are in themselves quite massive tomes, or whether we have to go back to the regulations. I do not know how you re-engineer the current implementation into this. I just wanted to offer an alternative way of approaching the problem.

Mr BYRNE—You were talking about the somewhat onerous burden of the regulatory requirements and whether there should be just a culture of compliance or whatever you want to call it rather than imposing regulatory burdens. There is a reason these burdens were imposed. To think of an example, I am aware that some insurance products were being sold via financial planners in the late eighties and early nineties, and they were financial planning firms that were connected with insurance companies. Not only did they not disclose that connection with the insurance companies; they also did not disclose the fact that they took virtually all of the first year's premiums as superannuation and then three-quarters of the second year's premiums. Because regulations were introduced, that practice has been stamped out. Doesn't that then negate your argument? We are talking about refining. Regulations are about catching unethical behaviour and thus encouraging people to be ethical, in the sense that, whilst there may be very good citizens like yourself out there, there are quite clearly a number of organisations and people et cetera that are not and that have been ripping people off. Consequently, you do need regulations, because once they are breached there can be punishment. So you are trying to both capture those people and punish those people for unethical behaviour.

Mr Baker—On disclosure, I think you have answered your question in many ways because the key to solving that problem was the disclosure requirements, which have been completed in this round of legislation and regulation, and I think that is a very good thing that it was a requirement. That is a step forward and it deals with the problem of the massive brokerages that people were achieving by selling those products on those days. I believe that problem is largely solved. The issue is that we seem to be requiring these massive amounts of process and procedure documents even if we are a small office, and we do not know how big that is at the moment. Not only that, another area which we have not touched on so far is the ongoing training requirements under PS146. They are very prescriptive, and to follow the procedures of fulfilling the requirements of PS146 in terms of ongoing training requirements is quite a massive time burden by itself. I think that degree of prescription and prescription about how you have every process in your office documented down to opening your mail is where things are getting carried away.

Mr BYRNE—I think you also address that by saying that that is not necessarily following the intent of the regulation on FSR.

Mr Baker—We hope that is the case.

Mr BYRNE—Just presume it is, but the way that was addressed was that you spoke to a person from ASIC. Mightn't the solution be that they have a dedicated person or group of people that can provide ongoing support and advice for smaller boutique firms so that that reduces the complexity and it can be explained? You could have them providing you with that ongoing support and information and constantly updating you so that you are not having to absorb that burden. Wouldn't that be a way of addressing some of your concerns?

Mr Baker—We found our meeting with Pauline Vamos very positive and very useful because it gave us a strong sense that ASIC had a sensible attitude towards things. As we identified earlier, part of our problem may rest in our own professional organisation. We have got to grapple with that and we have got to wrestle with it as far as we can and do the best we can with what we have to deal with. At the moment we are being faced with this monster that we are trying to deal with.

Mr GRIFFIN—The real question there is how much more activity and contact you are going to require with ASIC and how soon in order to resolve those issues or find out whether they are not resolvable.

Mr Baker—I do not know the answer to that.

Senator MURRAY—There is another problem which is not new which you have identified again and which we have heard from other witnesses. It relates to people seeking to make money out of the uncertainty and fear that people have with a new act and a new situation. It seems to me that if the act already covers engaging in misleading and deceptive conduct with regard to your interaction with the consumer, that should be extended all the way up the line to anybody who engages in misleading and deceptive conduct to the service provider. It seems to me that there are some people out there who are generating immense anxiety for the wrong motives.

Mr Baker—I agree entirely with that.

Mr BYRNE—I am looking for clarification that a number of your concerns could be addressed—the member for Bruce has mentioned this element as well—by concentrated attention and support that could explain some of those complexities to you. It also addresses Senator Murray's point, which is that if you have got someone who is trying to exploit your lack of knowledge about that then that can be identified fairly quickly.

Mr Baker—I do think the PS146 ongoing requirements are far too prescriptive as well.

Mr BYRNE—We have had testimony to that effect.

Senator MURRAY—I hope to see that in our recommendations.

CHAIRMAN—The issue you are referring to was, for example, the banks telling people that their accountants could no longer do their super fund.

Mr Baker—This might give you an interesting insight from within the industry that perhaps you may not have heard before. Let me describe this as a consequence of what feels like over-regulation. What is going on out there a lot, I believe, is advisers offering safe advice rather than the best advice. In that regard I mean advice that is safe for the adviser. Safe advice is where the adviser can check the compliance box and advice which can reduce the adviser's chance of being sued. This was reinforced at a dinner I attended recently with some very experienced planners in Brisbane.

Advisers find it very easy to recommend a five-star manager because they feel it enables them to more easily satisfy the reasonable basis test for advice or to be seen to be satisfying that test. The problem is that we have all known for years in the industry I am part of that there is absolutely no correlation between star rating and performance. The Van Eyck report last year reconfirmed that point. What we have here is a corruption of the system. There are even worse mistakes, I am told. The process works like this: if you get a five-star rating, you get a higher funds inflow if you are a funds manager. However, you do not get a five-star rating unless you pay the gatekeeper—that is, the researchers. If you are a boutique fund manager or if you just refuse to pay the gatekeeper, you do not get rated, but sometimes unrated funds are much better recommendations for the clients.

The industry's interpretation of the compliance rules is that the research houses have an effectively legislative mandate to tax both the fund managers and the financial planners. To further complicate matters, the trend seems to be that research houses do not seem to feel that they can make enough money simply researching, so they are heading into funds management themselves in a 'manage the manager' approach. We have a really twisted maze of interrelated interests and these interrelated interests work against independent, unbiased, purchased research. The problem I am trying to highlight here is that the need to be compliant in many cases seems to have overtaken the need to do the best job for the client. In that case, the client loses and, to me, that strikes me as the system going wrong.

Mr GRIFFIN—We call it the rich getting richer and the poor getting poorer. That is a part of it.

Mr Baker—That too, but it is a real corruption of the system.

Mr GRIFFIN—Also, you pay advisers to advise and, therefore, they advise, and they keep advising.

Mr BYRNE—The point you raise is a very good one, particularly in terms of compliance. Do you have any specific examples that you might be able to inform the committee of?

Mr Baker—What type of example are you looking for?

Mr BYRNE—The name of firms.

Mr Baker—A fund manager, for example, that would not have been rated?

Mr BYRNE—Yes.

Mr Baker—A very good fund manager that I have been using for some years is a firm called Hunter Hall. It is a small boutique fund manager. At the end of last year or the beginning of this year, ASSIRT finally gave them a star rating and said in their research that, over the last five, six, seven, eight or whatever years, they were producing a higher return at lower risk than any other fund managers. But these guys simply had not been rated before.

Mr BYRNE—That was because, you were saying, they deliberately do not provide that sort of star rating to—

Mr Baker—They would not have been interested in paying the gatekeeper.

CHAIRMAN—The gatekeeper being?

Mr Baker—The researcher.

Mr GRIFFIN—The researchers who come out and say what a great job you are doing.

Mr Baker—Because they do not research you unless you pay them.

Mr GRIFFIN—Like buying an Oscar.

Mr Baker—If I were to pay for research from these guys, I would want them to do objective research and research the best, but that is not what they do. They also research—

CHAIRMAN—When you say 'research people', you are talking about the Van Eycks and—

Mr Baker—The Morningstars and those sorts of people, yes.

Mr GRIFFIN—Do you have meetings planned with ASIC to go through issues as they come up? What is the story?

Mr Baker—No meetings planned, but Pauline Vamos has indicated willingness to help us work through those sort of things. One of the things, in the first instance, is that we intend to start giving some templates of our attempts to tackle different parts of the policy statements.

Mr GRIFFIN—And she has encouraged you to do that?

Mr Baker—She is happy for us to forward those and look over them. But what most of our group have said at the moment—and we have heard a hell of a lot of war

stories over the last few months with people trying to get their licences quickly—is that now we are looking through all these policy statements and we can see the whole host of issues we have to work through here. We do not expect to put licence requests in for another year or so until we can gradually work our way through this massive list of things that we want to try and deal with, otherwise it is just too big a job. We have just got to bite off a bit at a time.

Mr GRIFFIN—I think it is an evolving result, but the point I would make is that, if ASIC continues to do the right thing, as they appear to be doing, that is probably going to resolve a large part of the problem, if not all of it.

Mr Baker—If there is a very healthy attitude from ASIC, that will be a big step forward.

Mr GRIFFIN—Feel free to keep the committee notified if you have any problems.

CHAIRMAN—As there are no further questions, thank you very much for your appearance before the committee today, Mr Baker. It has been very useful.

Committee adjourned at 3.59 p.m.