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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Corporations Amendment Regulations 2003 (No. 1) Statutory 2003 No. 31 Regulation 7.1.29 in Corporations Amendment Regulations 2003 (No. 3) Statutory Rules 2003 No. 85

MONDAY, 16 JUNE 2003

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Monday, 16 June 2003

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

Senators and members in attendance: Senators Brandis, Chapman, Conroy, Murray and Wong and Mr Ciobo and Mr McArthur

Terms of reference for the inquiry:

To inquire into and report on:

- Corporations Amendment Regulations 2003 (No. 1), Statutory Rules 2003 No. 31; and
- Regulation 7.1.29 in Corporations Amendment Regulations 2003 (No. 3), Statutory Rules 2003 No. 85.

WITNESSES

Committee met at 7.41 p.m.

CHAIRMAN—The Parliamentary Joint Statutory Committee on Corporations and Financial Services resolved to inquire into and report on by 24 June 2003 the following regulations: Corporations Amendment Regulations 2003 (No. 1), Statutory Rules 2003 No. 31; and regulation 7.1.29 in Corporations Amendment Regulations 2003 (No. 3), Statutory Rules 2003 No. 85.

The committee advertised the inquiry on its web site and in the *Australian* on 21 May 2003. Invitations to participate in the inquiry were also sent to several financial sector industry associations and individual stakeholders. To date, 11 submissions have been received. They are available from the Parliament House web site or alternatively the secretariat can send a hard copy of the submissions to those who wish to obtain them.

As no objections were raised in submissions to the regulations set down in Corporations Amendment Regulations 2003 (No. 1), Statutory Rules 2003 No. 31, this hearing will focus on regulation 7.1.29, which did attract much comment. The committee expresses its gratitude to all of those who have assisted it so far with its inquiry.

Before we commence taking evidence, may I reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege in respect to the evidence they give. 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 him or her before the parliament or any of its committees is treated as a breach of privilege.

I also state that unless the committee should decide otherwise, this is a public hearing and as such all members of the public are welcome to attend. There has been a late change to the program this evening to allow the Law Council of Australia to appear in addition to the other witnesses that were listed. Time has been set aside near the end of the proceedings for a short discussion of the evidence and to allow witnesses to present a brief summary of their views. The hearing will commence by taking evidence from the accountancy bodies followed by Taxpayers Australia and then officers from the Treasury.

[7.43 p.m.]

AGLAND, Mr Reece, Technical Counsel, National Institute of Accountants

BOWLER, Ms Kathryn Laurayne, Director, SMEs, CPA Australia

DAVIS, Mr Peter, Principal, Peter Davis Taxation and Accounting Services

LAWRENCE, Mr George (Private capacity)

ORCHARD, Mrs Susan Janet, Superannuation Technical Consultant, The Institute of Chartered Accountants in Australia

PAYNE-MULCAHY, Mr Michael, Tax Counsel, Taxation Institute of Australia

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

CHAIRMAN—I welcome members from the accountancy profession to this hearing. As I mentioned earlier, this is a public hearing and so the committee prefers that all evidence be given in public, but should you at any stage wish to give any part of your evidence in private you may request that of the committee and the committee will consider a request to move in camera.

The committee has before it the following written submissions: a submission from Mr George Lawrence, which we have numbered two; a submission from Mr Peter Davis, which we have numbered three a joint submission from the Institute of Chartered Accountants, CPA Australia, the National Institute of Accountants and the Taxation Institute of Australia, which we have numbered five. If there are no alterations or additions that you would like to make to any of those submissions before we commence evidence, I invite you to make a brief opening statement or statements, at the conclusion of which I am sure the committee members will have some questions.

Mr Reilly—Thank you very much, Mr Chairman. I would like to start with a brief opening statement, and then refer to two of my colleagues—Kath Bowler to look at some of the issues in terms that accountants give in advising on financial matters generally, and then Susan Orchard, who has been involved with this committee before, in terms of some of the practical applications of regulation 7.1.29 as it relates to superannuation.

The accounting bodies appreciate the ongoing support of the committee. We have worked with you a number of times, so that support is very important to us. As a little bit of background, very briefly: we were reasonably happy with the original regulation 7.1.29 that was released in October 2001, but we have found, given the passage of time and starting to apply the regulation in practice, that some issues have arisen, particularly in relation to what was seen to be an anti-avoidance type provision, subclause 2. We have worked very closely with Treasury, and we have broadly supported the regulation that is currently before this committee. There is one particular issue that we have a concern over—that is, superannuation fund structures and then giving advice on that.

In our submission we attached a copy of a draft industry guide—it has been kept 'draft' because the regulation has gone through a fair amount of debate. That draft industry guide, which has support from ASIC in terms of the concept of the industry trying to provide practical applications to how FSR will apply, was really designed to look at practical examples of accountants' activities, to determine whether they were activities that required FSR licensing or not. We have gone through a revision of that draft to accommodate the second regulation 7.1.29.

I will not spend any particular time going through our submission; it is quite short. The real issue is the question of superannuation fund structure type advice. We believe that the FSR regime, which had its underpinnings in the Wallis report, was looking at licensing where a person, a consumer, makes a financial decision—invests in a financial product. Our industry guide has tried to draw a fine line between those instances where you are actually making an investment in a financial product and those where an accountant is providing financial advice, the ongoing normal accounting type advice that you would give to a particular client.

I would like to table some legal advice that I received this morning—apologies for the very late notice—which is a short legal advice from Phillips Fox. That draws attention to the major issue that we have with regulation 7.1.29—that is, where an accountant is providing a client with advice on the different types of superannuation fund structures, should that be a financial product and therefore require licensing, or should licensing apply where you actually put investment products into the superannuation fund so that the superannuation fund is then operational? We, the accountants, would argue that providing a recommendation on a superannuation fund structure which does not have any investment products in it is not a financial product advice, on the basis that there is really no gain or loss to the consumer or to the client as such; it is only when you are starting to put investment products in that it clearly requires licensing. We would argue that accountants are probably best placed, in the majority of circumstances, to provide that impartial, independent advice, where they are not being paid on a commission basis but simply on the time that they are putting in to explain what we would term factual differences between different types of superannuation fund structures. I will hand over to Kath to briefly go through some of the activities that accountants are involved in.

Ms Bowler—As Keith mentioned, FSR is about consumer protection when financial product advice is being given. Accountants do give a lot of advice on the financial affairs of a client and we are not denying that appropriate skills and knowledge are needed when they give advice on those financial affairs. That includes auditing advice, preparation of tax returns and advice on what business structures are most appropriate for that. This does not all belong within FSR—recognising those appropriate skills and knowledge. This has been acknowledged in regulation 7.1.29(3)(c), which recognises that when an accountant gives advice on the setting up of a business, on structural issues, they are entitled to do that without the need to be licensed. But they are not allowed to give advice on financial products that might rest within that structure, and the regulation clearly says that. Superannuation is just another structure, and excluding accountants from being able to give advice on superannuation structures is almost a contradiction of regulation 7.1.29(3)(c), which recognises the difference between advice on a structural issue versus advice on a particular financial product.

I want to finish with a case study. As Keith mentioned, we have been working on a guide for our members. One of the things we wanted to put in that guide was a case study, basically a script between an accountant and a client, to demonstrate what advice accountants can provide.

We sent this proposal to the lawyers—in this case a different set of lawyers: Clayton Utz—just to get some sign-off, and they basically gave the same piece of advice that Phillips Fox did. I want to quote what we put in and where the lawyers advised that they certainly were not prepared to put their names against it because they did not think it was acceptable under the existing regulation. The client says:

So which type of superannuation fund do you think would work best for me?

The accountant says:

Well, given the structures we are putting in place for you to start your business, from a business planning point of view, the Self Managed Super Fund would probably suit your circumstances. This is because there may be opportunities to free up business capital while also making provision for retirement.

However, with any superannuation option you choose, there will be investment decisions you need to make and there are a variety of issues to be considered when making this decision.

It then goes on to put in the various disclaimers that are talked about in regulation 7.1.29. I can certainly table that case study if you would like. Those are the two paragraphs that basically were crossed out by the lawyers, who said, 'No, you cannot make that statement as the regulation currently stands.' That is similar advice to that which we had been given from Phillips Fox.

CHAIRMAN—You will have to excuse us we have been called to attend a division. We will be back as soon as we can.

Proceedings suspended from 7.53 p.m. to 7.58 p.m.

CHAIRMAN—Ms Bowler, could you perhaps read into the record the actual title of the Phillips Fox document that has been circulated.

Mr Reilly—I can do that. It is legal advice that was provided by Phillips Fox, dated 16 June 2003, to me from the Institute of Chartered Accountants in Australia. The heading is 'Accountants—AFS Licensing Provisions and Superannuation Advice'.

Ms Bowler—I read from the case study titled 'FSRA Case Study—Setting up a SMSF'—that is, a self-managed super fund.

CHAIRMAN—Thank you.

Ms Bowler—I had basically finished what I was going to say. I will hand over to Susan to talk about some of the issues if the regulation does not go through in its current form.

Mrs Orchard—The key issue that I wanted to raise this evening was in relation to regulation 7.1.29 in its current form. Notwithstanding some of the challenges that are faced with the regulation in its present form, we certainly would find more difficulty if the regulation as it is currently proposed was withdrawn. One of the issues that are addressed by the regulation in its amended form is that, with regard to the role of an auditor, it enables us to undertake those audit

obligations without fear of being deemed to be implying a particular outcome from an advice situation.

As an example of that, if a fund breaches the in-house assets test, as an auditor I have an obligation to notify the trustees that they have breached that test and, ideally, I should be helping them through the rectification. That may involve getting them to sell down a particular asset or to increase a contribution or to increase the asset base. In times when markets are moving, we are seeing an increasing number of in-house asset type movements and so we need to be in a situation where we can in fact meet those obligations, in order that the responsibility does not fall on regulators such as the ATO to fill that gap, to help people through. The regulation which is there is an important part of making sure that practitioners can meet some of those legislative type obligations. What we would like to see is something added to the regulation in order to address the issues which were outlined by my colleagues earlier.

Mr Davis—Thank you to the committee for allowing me to attend this evening. My submission is reasonably self-explanatory, but I would like to elaborate on two additional matters. One is the lack of independence by people that are going to have to go out and get licensed because they have to have proper authorities from organisations which, basically, dictate and tell them how to do their work. I fail to see how there is consumer protection in that when they have been told, 'As a proper authority holder, what you have to do is to write such-and-such an amount of business. If you do not write X amount of business during a year you lose your proper authority.' That is a big problem.

The other thing is that the costs for consumers are going to escalate quite astronomically, I would feel. If we have to go and study to get additional licence—should that be the case for people in public practice—these costs are going to have to be passed on to the consumer. My concern is that, when consumers have to come and see us as public practitioners and accountants and get one particular bit of advice for tax, we have to say that we cannot talk about self-managed super funds or the product structure; we have to refer them to someone who has an Australian financial services licence. They are going to go and see them and get charged another fee. The person who is the financial adviser is going to say, 'I don't have a clue about your taxation affairs. You have to go back and get written advice from your tax advisers, or we are going to have to ring them up and spend a few hours chit-chatting and doing things.' All that is happening is that the consumer is paying an exorbitant amount of money and just going round and round in circles, getting nowhere. I will leave it at that, if that is acceptable.

CHAIRMAN—Thank you. Does anyone else wish to speak before we move to questions?

Mr Lawrence—I am a practising chartered accountant and I have been in practice since 1975. During that time I have been involved quite substantially in assisting clients in setting up self-managed superannuation funds. It is obviously clear that the one sticking point of the new regulations—it seems to be fairly universal amongst all the speakers here—is the so-called incidental advice, which was previously described, that we will be able to keep doing with clients. It is on that point that I would like to address the committee. On my reading of the legislation and the regulations, I would respectfully submit that the mere settling of a deed which is a deed of trust for a superannuation fund is not a financial product. I am in total agreement that what happens afterwards, vis-a-vis investing the assets of that superannuation fund, is and would be called a financial product or dealing in financial products, but I would submit that settling a

simple deed of a superannuation fund would in reality be the same as settling a deed of a family trust or a discretionary family trust.

In terms of recommending financial products, I would again emphasise that in merely advising a client from a practitioner's perspective and differentiating between particular types of superannuation funds—being able to talk with a client and telling the client the differences between fund A and fund B—it seems rather absurd to me that I then cannot recommend to the client what fund would best suit their needs in order to put those choices into practice. My main concern about that would be that if my client has to go to a complete stranger—one who does not know the client—and the client does not know the financial person, as compared with somebody like me who has had something like 30 years of practice and has spent a lot of time with clients, there would be inappropriate advice given at an extra cost, as my colleague said a moment ago. So in terms of the reality of giving financial advice, I would submit to the committee that an accountant simply advising a client to set up a self-managed superannuation fund is not dealing in a financial product until such time as the next step is taken—at which stage, yes, they would have to be dealing in financial products.

My practice has been, and always will be, to not talk to clients about financial products. I am not really interested in being licensed. I have an arrangement with an associate who is a licensed financial planner and I refer clients to that person. The client sits with that person and they discuss the various needs that they have and then that particular licensed financial planner will make the recommendation as to what they can invest in and what they should not. From a practising perspective, I do not believe there would be any loss of revenue, loss of face to the government or transgression of the law if we accountants were allowed to simply keep doing what we have been doing for the last so many years.

CHAIRMAN—Does that complete the opening statements?

Mr Reilly—Yes.

CHAIRMAN—Thank you. From what you have said, can I take it now that your only concern with regulation 7.1.29 is this issue of superannuation advice and that you are happy with the rest of it?

Mr Reilly—That is correct. We have spent quite a lot of time and effort on our draft industry guide, so we have provided practical examples of how the regime and the regulation will apply. The only proviso is that, as with the first regulation, over a period of time as you start applying the requirements in practice, questions are raised. Therefore, we would envisage that our industry guide would be a living document. It is not inconceivable that we may need to come back at some point in time and talk to Treasury, and Treasury have said that they are happy to look at this regulation and the regime, as they do with all other legislative requirements. But it is only the superannuation fund structure.

CHAIRMAN—I asked that because my recollection is that this committee previously recommended that accountants should only be required to be licensed if they were receiving commissions in relation to any advice they were giving. So even if they were giving advice on so-called financial products, that would not necessarily, in our view, trigger the need for a licence unless they were receiving commissions. But you are not wanting that issue revisited?

Mr Reilly—We would be happy to open that issue at some other point in time, but at this stage we are looking for a bit of closure in terms of the regulation, particularly as it applies from 11 March 2004. To be fair, in the longer term we will monitor how the regime and the regulation applies in practice. So I would not like to say, 'No, there will never be another issue to raise,' but at this point in time it is purely about if a person can give advice and a recommendation on a superannuation fund structure—that is, the difference between a self-managed fund, a small APRA fund, retail industry et cetera—that does not have any investment products. We would certainly argue that if there are investment products in there then a financial service licence is required.

CHAIRMAN—I cannot remember whether it was you, Mr Reilly, or you, Ms Bowler, who said in your evidence that there is no gain or loss to a client when they are being advised on a superannuation fund structure.

Mr Reilly—That was probably my comment.

CHAIRMAN—Aren't there different costs associated with different structures?

Mr Reilly—I would perhaps defer to Susan in terms of the costs in giving advice as to a superannuation fund structure. In terms of gain or loss, a consumer is not going to make lots of money or lose lots of money in terms of the actual fund structure itself; it is actually in terms of the investment products that are in there where the consumer then runs into the normal market conditions.

Mrs Orchard—There are differing costs between different types of products. I guess that comes down to your explanation of those types of structure. It would include an explanation of the different types of cost structures. Because we are not looking at actually recommending a particular retail industry product per se, and without actually mentioning brand names and particular products, to go in depth as to the differences in the pricing structure they would be referred to a financial adviser to assist them with choosing the right type of product in that category for them. The issue comes down to self-managed funds, small APRA funds, retail funds, industry funds, corporate funds and government funds. People in the marketplace have access to each of those types of funds. They may already be in one of those funds. We are looking to be able to say, 'This structure might suit this business operation' or 'This structure might suit you, based on what we know about your, your record keeping and other types of history; the types of funds that you have invested in superannuation or are likely to invest in superannuation.' They may lend themselves to particular product types. The industry that you work in may lend itself to a particular type of fund by virtue of your employer having an obligation to invest in that type of fund on your behalf, for example, in an industry fund or a government fund.

What we are looking at is to be at that very top end. When somebody comes in across the desk from you and asks you a question, we want to be able to be that generic and say, 'Yes, you could have a self-managed fund, but as a worker in that industry your employer is going to have to pay to that fund; to have two funds is going to incur costs; there are going to be some implications of that.' If they still want to pursue that option, you can send them to a financial adviser to discuss it further and to choose the right option for them. It is giving that generic type of information that enables you to make decisions without necessarily going to the cost of seeking specific

financial advice, which does come at a cost, in order to make that type of general assessment that may assist you in your decision making and the way that you make decisions yourself.

CHAIRMAN—Am I correct in saying that, from the evidence you have given, your two objections to the requirement with regard to superannuation advice are firstly, the cost of being licensed and secondly, what you foresee as the loss of independence to be a proper authority holder of a licence? Are there any other issues?

Mr Lawrence—With respect to my colleagues, let me give you an example from a practising point of view at the real grassroots level: Mr Jones wants to set up a new business. He comes to see me and he says: 'How do I set up the business? Should I be running it as a partnership, as a company, individual or whatever?' Let us assume that I tell him that he should set it up as a company. In that case, we immediately have superannuation issues because of the mandatory nine per cent superannuation guarantee contribution. He says to me, 'How am I going to do this?' It is at that stage that we have this approval that we can advise by saying, 'You have the choice of doing this; you have the choice of doing that; you can go to this fund or that fund.' So that is clear. The document that Mr Reilly referred to which was emailed to practitioners is a 35-page document. It is a very good guide to practitioners. It goes through a question and answer situation of yes, we can do this, no, we can't do that. When the person sitting in front of me says, 'I've heard that some of my friends run their own self-managed superannuation funds, can I do that myself?' at that moment I would think that I could not recommend to him that he should set up a self-managed super fund and have control over his destiny as distinct from sticking the money into the Westpac self-employed person's super fund.

For me, that is the simplest issue. Cost is not that much of an issue as some funds can be set up for as little as $500 while others cost $2,000; there is a fair range there. It is a matter of being able to say to a person, 'Yes, I know you want to have charge of your own destiny, and, yes, you want to have that independence, but, no, I can't tell you to do that. I can run you through the choices that you might have.' I have to try and somehow put words in that person's mouth, and he might come back to me and say, 'George, I've been sitting in front of you and I hear what you say and I now have decided to do my own super fund and I want you to help me set it up.' Then I can do it. So I can do here, I can do here, but I cannot do this bit, and it is really a very simple thing.

If I say to the guy, 'Listen, if you set up your own super fund, you can do this, you can do that, you can't do this, you can't do that,' for me, I cannot see that that can be financial advice. That is the coalface stuff, rather than, with respect to the other people, getting involved in great technical matters. I think we are all agreeing that we support the regulations or the Financial Services Reform Act, the issue is just one little definition which started out with incidental advice and what incidental advice was. The regulators wrestled with that and then that was done away with and something else came out. In terms of recommending a set up, which I can do, I can tell somebody to trade through a family trust, through a company or through a unit trust or a partnership. I can do that as it is not financial product advice. But if I say to them, 'You can run your own super fund,' at the moment that is financial advice.

CHAIRMAN—Getting back to the issue of you not being able to do that, you can do it if you get licensed. The reasons for wanting to avoid the requirement to be licensed are the cost to you of getting licensed and the fact that you would lose your independence or you may not be able to

meet the requirements of the person that is going to provide you with a proper authority in terms of their sales budgets and so on.

Mr Lawrence—Licensing is one thing. As I said, I do not see the great issue with licensing because I really think if we stay with the status quo we can play games with the clients and say to them, 'Look, I can't tell you to do this. I can give you the choices, you've got to make the choice.' If he really understands what I am saying between the lines he can come back to me and say, 'Yes, George, I made a choice. I want you to do this.'

Mr Davis—The cost of getting a licence is still quite expensive. To get a proper authority, to do the training, to cover all the bases for insurance, auditing and everything else, will still potentially cost well over the $10,000 to $12,000 mark. Last year we were talking maybe $20,000 to $25,000-odd, from memory. It is still extremely expensive. Assuming the regulation stays as it is today and as it is gazetted, if I want to recommend self-managed super funds to my client, I have to have a licence. If I choose to go and get a licence, I have to pay that money. If I have to pay that money, I have to recover that cost somewhere in running my business. That is a normal economic consideration. So my overhead costs go up and all my clients pay, or I choose not to recommend superannuation funds for my clients and I send them down to a financial adviser. A financial adviser, as I said before in my evidence, does not understand about their taxation affairs and you have a to-ing and fro-ing thing which still means that the consumer is paying additional costs in his fees anyway.

Ms Orchard—I have a different perspective to put on that. In addition to my role with the institute, I am also a sole practitioner who audits small funds. I have undertaken the training required to get a grad dip in financial planning. At the end of doing that course what I felt was that in order to go down the licensing track, in order to justify the ongoing obligations in respect of training and a lot of other things, you would have to find yourself in the situation of product sales, and that is not something that sits comfortably with me or my business structure at this time. But because of cost, training and other issues in terms of maintaining that authority once you have one, I felt that I was being directed down a business path that did not suit where I was coming from. I think that is something else which impacts on a number of people in this area. They do not see themselves as product sellers or product providers. They see themselves as people who are advising business and who are giving advice to individuals through the tax return process. They are being moved away from compliance, and that role of offering support and assistance, down a licensing track and into directions that they perhaps did not envisage or did not choose for their business to go. I think that is something else to bear in mind.

Ms Bowler—In terms of the cost, I think if we get mixed up in whether it is expensive or cheap to get a licence, that is missing the point that this really should not be financial product advice under this particular regulation because it is not the same type of advice with the same consumer protection that is needed. As I mentioned, that has been recognised in that accountants can give advice on structures when it is not in the superannuation environment. I am not quite sure why that same advice is different when it is a superannuation structure effectively setting up a trust for a company. You are not telling them where to invest their money.

CHAIRMAN—Is this the problem that really arises out of the attempt to have a one size fits all regime under the financial services reform? I think it is a laudable objective, but there are bulges that do not really fit the model.

Ms Bowler—The definition of financial product advice under FSR is so broad and I certainly recognise the difficulty in providing an exclusion for accountants to continue to do their traditional activities without providing such a wide exemption that it could be abused. I recognise that difficulty and that would explain why the regulation in its current form is so complex, and even if this area was fixed up the regulation would still be complex for that very reason. I do not think we will ever remove that complexity because of FSR and product advice being so wide.

Mr Reilly—I guess the government at the time had the opportunity when FSR was being debated to follow the Wallis recommendations and the recommendations of this committee in giving exemptions for lawyers and for accountants/tax agents in terms of their normal activities. What the early version of regulation 7.1.29 did, and what the later version has done, is to effectively try to do that. We are looking at one specific issue where a superannuation fund structure, which has no assets or liabilities as such, is being defined as a financial product in the same way as a recommendation to purchase shares in a company. So that has really been the issue. We have gone a fair way down the track. The regulation is somewhat more complex than we would like—that's life! Our industry guide is designed so that our members, and others, can read that and interpret it as best they can. But in one particular area, namely the superannuation fund structure, you can provide factual advice on the differences between different types of funds. You can actually prepare a spreadsheet where you list the differences but you cannot then say, 'Based on the results of my analysis and my discussion with you as the client, this fund would appear to suit you better than the others.' What you have to say to the client is, 'I cannot tell you that. You might be able to work it out in terms of how many ticks or crosses are there, but you, the client, have to make that recommendation or go to someone who is licensed who is a financial planner supplier, product flogger—call it whatever you want—to actually give that sort of advice'—which they would not give. What they will give is advice on what investments to put in there. That is really the issue.

CHAIRMAN—Could there be a possibility that the financial planner might give the wrong advice in that, given that they are driven by sales, it might be to their advantage to have someone in a managed fund rather than a self-managed fund?

Mr Reilly—We would like to argue that the financial planning industry would not be tempted to go down that path.

CHAIRMAN—Mr Payne-Mulcahy, what comment do you want to make?

Mr Payne-Mulcahy—Just along the lines that you spoke about a generic definition. We have moved to a generic definition of a financial product. It is meant to be an expansive, organic concept that meets market needs as the market throws up new products. I suppose that what we are really arguing is that the superannuation structure is really not something that we think really falls within the spirit of the generic definition of a financial product; that the definition, we believe, is sufficiently flexible to enable us to argue that it does not fall within that broad type of definition.

Senator CONROY—You could argue that the earth is flat as well, if you like.

Mr Payne-Mulcahy—I am not too sure I understand.

Senator CONROY—And we won't invite the product floggers to respond to you later, Mr Reilly. I am just reading your submission and we have covered a lot of this already. The issue seems to be about whether an accountant, in recommending that their client establish an SMSF, is providing financial product advice to their clients. I think that goes to the heart of the point that was just being made. I note that your joint submission states that accountants are not providing advice in respect of a particular superannuation fund or particular investments, and you consider that the advice does not constitute financial product advice and therefore should not require an AFSL. In my view, and to some of you it will not come as a great shock, accountants and others are providing such advice. The law is quite deliberate in attempting to capture this, and I do not believe a regulation could even be framed that would allow it out, because the law is quite specific. In my view, you are providing advice as you are recommending a class of financial products and section 766B(1)(a) states that financial product advice means a recommendation or a statement of opinion that is:

... intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products ...

You can sit there and say superannuation is not a class of financial products and frankly you may as well argue that the earth is flat.

Mr Payne-Mulcahy—We are arguing not that superannuation is not a class of financial product, but rather superannuation structure is not a part of a financial product.

Senator BRANDIS—Sorry. What do you define as superannuation structure?

Mrs Orchard—That comes back to my example before of the six types of funds at that very broad level. Those six classes are small APRA funds, self-managed funds, industry funds, retail funds, corporate funds and government funds. Part of the issue is that if somebody comes in and asks me to set up a self-managed fund, under this regime as it stands, I actually have to go ahead and set up that fund for them. I cannot talk to them and counsel them perhaps if it is an inappropriate thing for them to do based on the fact that they have a very small balance or that their record keeping and tax keeping has not been good in the past. So on the flip side that is also considered to be intending to influence under this regime.

Senator BRANDIS—So what you described as a set of classifications, is it your point that in providing advice as to the choice among that group of classifications you are not providing a financial product—

Mrs Orchard—That is right. What we are saying is that amongst that group of classifications something may suit you because of your circumstances. For example, because you work in the metal trades industry your employer has an obligation to contribute to a particular fund. If you come in and say to me, 'I want a self-managed fund,' and you have got $20,000 in that existing fund you are still going have to accumulate money in that fund. It may not be wise thing to do under this regime. I am intending to influence if I try and counsel you against that fund. So we are looking at that very high level.

Mr Lawrence—With respect to Senator Conroy, regulation 7.1.29(5)(a) states that for this regulation, the person also provides an exempt service if:

(a) the person provides advice in relation to the establishment, operation ...

I think we really missed the point. We are talking about the establishment of a fund. The establishment of a fund is the mere signing of a bunch of documents. If this was an act of parliament this would be the same as a superannuation fund. Establishing a super fund is simply signing a document under the Superannuation Industry (Supervision) Act which says that this fund is set up by the employer for the benefit of the members for their retirement; end of story. It is a piece of paper which is then signed by the trustee, signed by the member, stamped in some states, and not in others, and that is it. That is the establishment of a super fund. At that stage—

Senator BRANDIS—The distinction you are drawing is a distinction between the creation and the operation.

Mr Lawrence—Precisely. At that moment the fund has nothing in it.

Senator WONG—But the decision to go to that structure itself is a decision of about financial products and the point is—

Senator CONROY—You could adequately say that the law requires you to establish a formal fund. That is, explain that facts to them. For you to then take the next step and recommend a particular type of fund is to not create something that zero goes into by choice, it is a mandated amount of money that has to go in according to the government.

Mr Lawrence—With respect, not until the end of the year.

Senator CONROY—Well—

Mr Lawrence—If we are going to play that game, then it does not have to go in at that moment.

Senator CONROY—You can play that game. Unfortunately, the legislation requires quarterly payments. The explanatory memorandum is quite clear. It says that under FSR recommending a person establish a SMSF structure is a superannuation investment decision as it is equivalent to recommending a person becomes a member of a SMSF. That is absolutely straight up and down: you are recommending that they are better off in that style fund rather than another style of fund. That is an investment decision and consumers are entitled to understand that the person who is making that recommendation is qualified to do that. That is really the beginning and end of the story.

Mr Lawrence—With respect to you, there is nothing to invest, there is absolutely no investment.

Senator CONROY—Except a guaranteed trail of nine per cent per year. For you to try and argue there is nothing to invest is, frankly, embarrassing.

Mr Lawrence—Why?

Senator CONROY—Because it is mandated once they set it up that they have to put money in there. It is not like you have convinced them that it is a good idea, that they are going to get the best return; you are just saying, 'This is the vehicle you are going to better off.' You are making a judgment about how—

CHAIRMAN—Not in a self-managed fund.

Mr Lawrence—No, not at all, Sir.

Senator CONROY—You are making a judgment for them.

Mr Lawrence—Not at all, Sir, not at all.

Senator WONG—Your own legal advice, Mr Reilly—

Senator CONROY—Says that.

Senator WONG—In paragraph 13 makes it clear, and I think that is why we are here.

Ms Bowler—But that is our point.

Senator WONG—Precisely. It does fall within the FSR regime, the question is whether or not, as a matter of public policy, you should be required to be licensed to provide that advice.

Ms Bowler—That is exactly it.

Senator WONG—So let us not go down the path of saying it is not financial product advice, it clearly is.

Ms Bowler—It clearly is, under the definition.

Senator WONG—And that definition has been set by parliament. What we are talking about is whether the regulation ought to be amended. I would share Senator Conroy's concerns as to whether we can in fact amend it so we are consistent with what the legislation says, but let us leave that for another day.

Mr Reilly—I think we probably can. That really is part of the issue.

Senator WONG—I do not really want to go down that path. What I am more interested in is why you say you ought not to have to be licensed to provide what seems to me fairly clearly to be advice about different investment structures for people's superannuation.

Ms Bowler—I would go back to the example of non-superannuation structures. Let us say a client wants to make regular investments of $100 or $1,000 a month into an investment. An accountant is in a position to determine whether it would be best to make that contribution through a trust, through a company or as an individual for that business. It works out which

structure is going to suit the client best. The client then has to get advice as to what products they use to make that $1,000 a month contribution.

Senator CONROY—I think you are making a cogent case, Ms Bowler, why the law is deficient in not including those other structures. I think you have made that case very well and I would urge the government to include them all as well.

Mr Reilly—I would perhaps argue, Senator Conroy, that is not quite the way we have seen it. If you go through the Phillips Fox opinion to paragraph 20, Phillips Fox then look back at whether a superannuation fund structure should in fact be a financial product. We are not debating that it is currently caught by the regulation. What the comment is there is that it is the accountant who is best placed to provide that impartial, independent advice. We would argue that the consumer is not making an investment decision because there are not investment products in there. There are no trails in setting up a superannuation fund structure whatsoever. Where the trails come through is when a licensed financial adviser is required to actually put investment products in that superannuation fund. I guess that is the difference. If you look at it, the whole purpose of regulation 7.1.29 was to actually try and provide some clarity and some clear public policy exemptions for why the terms 'financial advice' and 'financial product advice' was just too broad; otherwise you would require everyone to be licensed.

Senator CONROY—You make a good case about the evils of the commission structure, and it is one, as you know, that I have taken up in a number of forums. I will now be quoting you in support, Mr Reilly. But again, I do not think it actually makes your case at all. I think you are simply pointing to an inconsistency that I agree is inconsistent, but I would argue the regulation should be going in the other direction, to capture, not to further exempt and take all these others. To argue that superannuation is not an investment decision is absurd.

Mr Reilly—I think that we have argued that. The government has said that if you are employed you are required to make a contribution of nine per cent per annum to a superannuation fund. We are not arguing that the actual investment products that are purchased as part of that nine per cent trail of cash do not require licensing. We are quite specific: it should. Superannuation is no different from a number of investment product decisions. It is the terms of the structure. Ms Bowler made reference to the fact that superannuation is just another trust structure. Accountants are properly placed to provide that type of advice. To require licensing will require accountants then to provide investment product decisions, so they will be financial product floggers—I think that was the term I used earlier, which no doubt will cause me grief at some later stage.

Senator CONROY—In about 20 minutes.

Mr Reilly—We are not arguing for that at all. We are not requiring licensing. That is the issue. Our submission sets out our belief that there is an anomaly in the act. You can provide factual advice to a client as to the difference between different types of structures. That is the type of advice that accountants are able to provide. The client would say, 'Which one is good for me?' The accountant would then say, 'I am sorry, I cannot give you that advice; you will have to see someone who is licensed or you will have to make your own decision.'

Senator WONG—Or the accountant has to be licensed in order to provide it.

Senator CONROY—You continue to make the bald assertion that accountants are properly qualified to give this advice.

Mr Reilly—We certainly do.

Senator WONG—Is the nub of your argument that you think your profession is sufficiently qualified not to be required to be licensed to give that advice? It is not a trick question; I am genuine. Is that the basis of the argument?

Mr Reilly—Our argument is that there are not investment products there. Licensing is there to protect the consumer—to ensure that the consumer is given advice and proper recommendations where you are looking at investment products.

Senator WONG—In relation to financial products?

Mr Reilly—Investment products. I guess I use that term fairly carefully. That is the difference. We are arguing here that the original definitions of 'financial advice' or 'financial product advice' contained in the original regime before 7.1.29 was brought in, or before there were amendments made to the original bill in the Senate, required everyone to be licensed, including auditors. They were already required to be licensed in a different regime.

Senator WONG—We are not going to go back and argue all that again. I am keen to understand precisely your objection. Is your objection as a matter of your regard for your professional qualifications or is it cost based to having accountants required to be licensed to give that advice? I am interested, Ms Orchard, in your comments earlier.

Mrs Orchard—Certainly I would feel comfortable, with my training as a chartered accountant, to give advice on the broad classes of superannuation. It is part of our postgraduate training. You look at the classes of superannuation and you have some understanding of those. If I did not feel comfortable with that, to update my knowledge I could download a document that is produced by ASIC or a number of other organisations that provides an understanding of the advantages and disadvantages of each of those classes. I feel that at that class level, certainly there is sufficient information in the marketplace to become educated in that.

Senator CONROY—How many accountants have a postgraduate qualification that, as you have described it, covers superannuation?

Mrs Orchard—Certainly it is a part of the chartered accountant CPA qualifications. In relation to others, I am not sure.

Senator CONROY—Would it be 20 per cent or 50 per cent?

Senator WONG—Of practising accountants.

Mr Reilly—We have had a requirement to do what we call our professional year and our CA program since about 1972, so it would cover the vast majority of chartered accountants. CPA would be similar.

Senator CONROY—I just got the impression that this was an extra qualification that you undertook as opposed to the standard qualifications.

Mrs Orchard—I have done both. I was referring to my CA qualification which contains that information. I would like to be able to address those needs of my clients, be it to refer them to financial advice to get information about a particular product when it was appropriate, and to have the discretion to point out what is an obligation of their employer to pay to a specific fund and the risks of setting up additional funds to that, because there are risks to setting up more than one fund. There are costs involved in doing that. On occasion you have to do that without having a business decision of getting a licence being forced upon me when I am not in the business of selling a product and I am not in the business of preparing financial plans. I am in the business of auditing self-managed funds.

Ms Bowler—If I can add to that, I have done the diploma in financial planning and we did not cover the structural issues for superannuation. It covered what you should invest in, it covered all the different types of superannuation products, but it did not cover whether a self-managed super fund, an industry fund or a retail fund is most appropriate. I do not think it was considered part of financial product advice.

Senator CONROY—I think you make a very strong case for lifting the standards of education for financial planning, Ms Bowler, but I know you a major contributor to that already.

CHAIRMAN—Can I ask whether you accept the logic of Senator Conroy's position, that if you—

Senator CONROY—Can they say no before you finish?

CHAIRMAN—No. If you have to be licensed, as he thinks you should be, to provide advice on superannuation structures, you should also have to be licensed to provide advice on appropriate business structures generally in terms of whether someone has a company, a discretionary trust or a unit trust—whatever—and vice versa, if you do not believe you should have to be licensed for those, the reverse logic is you should not have to be licensed for a superannuation structure.

Mr Reilly—I think that is a fair summary. If you accept the argument that there are financial products then you would argue that auditors probably should be licensed under the financial services regime because, when doing the audit of a company, if the auditor becomes aware that some key assets are not insured at all, the auditor is under an obligation to draw that to the attention of management and the directors. One would argue that that is a class of financial product, being insurance. At the moment regulation 7.1.29 exempts auditors in terms of that class—loosely called 'class'—or it exempts auditors in terms of providing advice that, yes, you should consider insurance. It does not provide an exemption for auditors in terms of recommending a specific insurance policy from a specific company. So I think that is probably a fair summary.

Mr Davis—I would like to object to that—

Senator CONROY—To me or to Mr Reilly?

Mr Davis—No, to your logic, Senator Conroy, on the basis that Senator Chapman is putting, and I think you were putting, that if you have to have a licence to recommend a structure for super funds, you have to have a licence to recommend investment in companies, in family trusts and in different things. My understanding would be that I have a taxation licence from the Australian Taxation Office and that those types of structures—it is a very loose terminology, as I think you are putting—come under the Income Tax Act. I would put it to you that I am licensed already under the federal government to give advice in those matters because I am a registered tax agent.

People set up different classes of structure depending on how they want to run their business and taxation affairs for the business at the time they are looking at it—it may not be ultimately; they may have to change their structure. A superannuation fund again, I feel, would possibly come under that sort of classification. You talk about getting a trailing commission. I am not sure that I heard you correctly—I would appreciate your advice—but you said you were getting a trailing commission at nine per cent. I do not believe that is correct. You said you get trails if you recommend that people set up their money in a self-managed super fund. I do not believe that is correct.

Senator CONROY—If I can put your mind at rest, I did not say that. I said that with a super fund you are government mandated to put nine per cent into it.

Mr Davis—But then you used the word 'trail', sir.

Senator CONROY—I was then talking about something else in terms of an issue that Mr Reilly raised.

Mr Davis—My apologies.

Senator CONROY—They are two separate issues.

Mr Davis—I took them to be the same one.

Senator CONROY—They ran after each other, so I can understand that it may have sounded like that from this far away.

Mr Davis—So long as there is not an inference that there is a trailing commission coming out.

Senator CONROY—I have not suggested that at any point.

Mr Davis—That is how I heard it; my apologies. Other people may have confused it too.

Senator CONROY—In looking at your argument that you are qualified on these other issues—I think Mr Lawrence made the point at the other end—you set up an empty vehicle, it is an empty shell, then there is a decision to be taken after that. The difference with super is there is no decision to be taken. When you set it up, nine per cent is mandated to go into it. It is held, it is fixed, it grows et cetera. It is not the same as a trust where there is a discretion by the individual about whether they put money into their trust or they put money into something else. It is just not the same. They are required by law to invest into the structure that you have set up.

Mr Lawrence—Not necessarily, with respect. They could put it into a bank fund. If we are going to draw that as a very clear line—

Senator CONROY—You are recommending it to them.

Mr Lawrence—Yes, we are. But if we are going down that track too, if we are saying that they are mandated to put the nine per cent, or soon to be 12 per cent, into their own fund, they are not mandated to put it into that fund at all. I agree, it would be a bit of a waste of time to do it, but if we are going to play that sort of—

Senator CONROY—You obviously have not sold them—

Mr Lawrence—But if we are playing the semantic game—

Senator CONROY—the arguments well enough if they change their minds.

Mr Lawrence—There are approximately 250,000 self-managed super funds in Australia at the moment, the last time I saw the statistics. They all have to have fewer than five members, so we are talking about small business—very small business. They used to be called mum and dad funds or DIY funds. So when we are talking about people asking their employer, the employer is the same as the member of the fund, and a lot of the time they are the trustees. I am the first to acknowledge that some people have done the wrong thing. But if you look at the 250,000-odd super funds that are being managed and run in Australia—and I can speak for the 90-odd funds which I audit—it is without question that not only have they outperformed most public funds but also that those people have prudently invested their assets on advice from stockbrokers, real estate agents or other people as required, not from me. I have not been involved. And that is the real issue here.

When the SI(S) Act was amended a few years ago there was a great fanfare made about the fact that superannuation funds can now buy their own business assets where the business is located on their property. So I thought the government was moving towards that kind of recommendation to allow people to take control of their own destiny. If a person wants to take control of their own destiny and they have to ask somebody, I submit to you that the best person to ask is their accountant, the one who has been with them for 15 years, 20 years or 30 years, not a stranger. I agree with you: at the moment the regulation says that a superannuation fund is a financial product. I am arguing that the regulation should be amended, very clearly. That is my point.

Ms Bowler—Once a self-managed super fund is set up it has to have an investment strategy developed for it, and that is where the advice needs to be given by someone who is licensed. They have to contribute nine per cent compulsory contributions and they still have to develop an investment strategy and get advice as to where that money is invested.

Senator CONROY—It still recommended one style of superannuation product over another.

Ms Bowler—Regardless of which style of structure you pick, you could go with any—

Senator CONROY—But you are recommending. They are not picking, you are recommending to them.

Ms Bowler—If you recommend a self-managed super fund verus an industry fund versus a retail fund you can invest in exactly the same thing regardless of the structure, but the difference is the level of control, tax issues, succession planning and a whole host of other things.

Senator WONG—Which has significant potential impacts on consumers' long-term financial interests, and it may be the right decision. The issue is whether you should be licensed to make that recommendation. I do not want to go on and on about this, but I am interested in the issue of cost. Mr Davis talked about $10,000 or $12,000. I seem to recall, Mr Reilly, you and somebody else giving evidence—I think it was in Sydney—about the exorbitant costs that were going to be associated with accountants becoming licensed. Are you able to provide us with figures on what you say it would cost you to obtain relevant licences?

Ms Bowler—I can comment on that because I made the statement. CPA Australia explored the possibility of obtaining a dealers licence to help members become authorised. The cost we were looking at under that structure was around $25,000 per annum to give full financial product advice. We were looking a restricted licence option, just to give general advice and advice on structures and such things. The cost would still be around $10,000 to $12,000 per annum under an authorised representative arrangement.

Senator WONG—With you being the—

Ms Bowler—With us being the dealer. We are looking at other options now. But again, whether it is $10,000, $50,000 or $5,000, I still come back to whether this is financial product advice with the same risks.

Mr Reilly—Investment products.

Ms Bowler—Investment products—whether it should be.

Senator WONG—Did you want to add to that, Mrs Orchard, about the costs?

Mrs Orchard—I have had talks with dealer groups about becoming an authorised representative. One of the issues that I face as a small practitioner that often shares a client base with other accountants—I audit funds, so I am the independent auditor—and clients often seek their financial advice from other sources, is that, yes, I may be able to get a licence in the first year, but will I be able to retain that authorised representation in the years ahead? The dealer group undertakes significant costs in having to ensure that I am trained, that I have appropriate insurance, and all the other add-ons that go with licensing, and they need to get some recoup for that. They do not get any of my practice, so after 12 months I get chucked out and I am back in the same situation.

Senator WONG—Yes, I appreciate that. Ms Bowler, how have you calculated the $10,000 to $12,000? What does that assume?

Ms Bowler—PI insurance is a big one, ongoing training requirements—

Mr Reilly—There are audit requirements under ASIC, so the practitioner would be required to be audited and the practitioner is required to provide certain documentation—all geared up for investment products which we support in terms of licensing. So most of the cost structures are designed to go around the investment product area.

Ms Bowler—And certainly for a dealer of any magnitude, the systems and compliance procedures they have to have in place to monitor the advice being given brings about significant cost. So a dealer group that operates out of any more than one or two offices needs fairly sophisticated electronic compliance systems.

Mr Reilly—The anecdotal advice that we have had in talking to different dealer groups is that most dealer groups have not been structured as yet to look at superannuation structures; they have all been around investment products that they are putting in. I guess to some extent it is new territory, and if the regulation is not changed then that needs to be looked at.

Mr Davis—I can confirm my colleagues' advice on that. I have been looking at the costs involved in me doing it, and they are substantial amounts of money, as Ms Bowler and Mrs Orchard are saying.

Senator WONG—I recall you giving similar evidence previously to the committee.

Mr Davis—I have been looking at it actively and the biggest problem is the fact that the authority holder, the principal licence holder, demands a certain investment strategy or investment return from the client.

Senator WONG—Not if it is this lot, presumably.

Ms Bowler—It would not be if it were CPA, but CPA is not prepared to take on the risk to set up that business, so it has left our members with no options.

Mr Reilly—We are looking at per annum costs. Yes, there are some initial set-up costs, but they are ongoing costs per annum.

Mr Davis—It is still quite an extravagant addition to the consumer to have to help fund. We are not all fairy godfathers; someone has to help recover our costs. We do not have the cash flow to pay it all out on our own and it is going to increase the costs to the consumer. When they come to us and ask us why our fees have gone up, we only have one answer to give: the licensing regime.

Ms Bowler—The reality is that accountants would not become authorised representatives if the cost remained at $10,000 to $12,000 per annum. The advice will then become fragmented and the client will get poorer advice. That is the reality.

Senator WONG—On what basis do you make that assertion?

Ms Bowler—Standing in front of 3,000 accountants—they will not pay $10,000 to $12,000 per annum.

Senator WONG—So the issue is if they are not licensed—

Ms Bowler—If they are not licensed, the advice will be fragmented, because they are getting structural advice for two-thirds of their affairs from the accountant, and then for this little bit of superannuation they will be going externally and there is a high chance that the advice will cause inconsistencies.

Senator CONROY—It is not an annual fee of $12,000, is it? Isn't it a one-off fee?

Ms Bowler—Annual.

Mr Reilly—It was annual.

Mr Davis—It could be annual, Senator, because you have to go on training—

Senator CONROY—Could be or is?

Ms Bowler—It is.

Mr Lawrence—The insurance would be at least $8,000.

Senator WONG—What does Treasury say?

Mr Davis—Treasury can no doubt answer that question.

Senator WONG—I suppose we will ask them what they say the costs are.

Ms Bowler—I can give you detailed spreadsheets on the $12,000.

Senator WONG—So I assume you have had these discussions with them, Mr Reilly.

Mr Reilly—We have not had any response, from memory, from Treasury in terms of costs. We have argued a cost factor. Treasury has not, from memory, come back to us and said that those costs are too high or too low.

Senator WONG—Perhaps we can clarify that.

Mr Reilly—But you should ask them, rather than me verbal them.

Mr Lawrence—I can truthfully add that licensing does not guarantee good advice. I refer people to the *Choice* magazine article which appeared in the January-February issue which was on the ASIC survey of the financial planning industry. I do not have a great love of the financial planning industry and I am quite happy to acknowledge that up front. However, I work with them because I have to because of the licensing requirements. But in terms of what we are saying, people having to be licensed at a very large cost is not going to guarantee good advice. In the 30-odd years that I have been in practice, I have not seen one financial planning recommendation which recommends the setting up of a self-managed super fund and which

recommends anything other than managed funds. It is an absolute fact of life that the financial planning industry works on commissions; they do not work on fees for service and therefore they do not recommend self-managed superannuation funds. So if they are going to push people into that area, we may as well forget self-managed superannuation funds as they will cease to exist. That is the reality of life.

CHAIRMAN—That was the point I made obliquely earlier, wasn't it?

Mr Lawrence—Yes, you did.

Ms Bowler—I was on the panel for the *Choice* survey, and the only people who recommended self-managed super funds were authorised representatives with an accounting background.

CHAIRMAN—As there are no further questions, I thank all of you. We have gone well over time, which I think shows the interest that the committee had in what you had to say, so thank you very much for your submissions and your answers to our questions.

[8.57 p.m.]

McDONALD, Mr Peter James, National Director, Taxpayers Australia Inc.

MOONEY, Ms Caroline Faye, Financial Services Adviser, Taxpayers Australia Inc.

CHAIRMAN—The committee prefers that all evidence be given in public but, if at any stage of your evidence you wish to give evidence in private, then you may request that of the committee and we would consider such a request to move in camera. We have before us your submission, which we have numbered seven. Are there any alterations or additions you want to make to the submission at this stage?

Mr McDonald—No, thank you.

CHAIRMAN—I invite you to make a brief opening statement, at the conclusion of which we will move to questions.

Mr McDonald—Thank you, Mr Chairman. Firstly, I will give some background about Taxpayers Australia. We were established in 1919 as a watchdog and an educator of taxpayers, and we have tried to carry out that role faithfully since that time. In 1997 we set up an arm of our organisation, called Superannuation Australia, to specifically look after the interests of what we term as do-it-yourself superannuation funds. We are referring to them now as small managed superannuation funds and, again, we are there to look after taxpayers' interests and act as a watchdog to make sure that they actually get what they deserve. I mean that in a positive sense, not a negative sense. We would like to point out to the committee that we support licensing for financial advice. We think it is absolutely mandatory but we also equally support the need for protection of taxpayers and consumers, and that means the trustees and members of self-managed superannuation funds. We also support the concept of choice. We believe that taxpayers are actually making that decision of choice with their feet: they are moving out of the managed superannuation fund industry and the other major retail type funds into small managed funds for very definite reasons.

We have gone to the stage of developing what we believe is a service that helps to increase the knowledge and skills of those people who are involved in the small managed superannuation fund industry, and we are referring here both to advisers and to the trustees and members themselves. At this point, I would like to apologise for Barbara Smith, who is our executive director, who is not able to be here tonight. She is one of the pre-eminent DIY experts in Australia. Unfortunately, she is presenting a seminar in Sydney for about 200 people who are now considering whether they want to go down the self-managed superannuation path. I would like to tender to the committee a copy of a manual that we have produced for those who have gone into the small managed superannuation funds area. It is an example of the sorts of things that trustees and members who go into this area need to know, and it will give you some idea of the issues that we believe are really taxation advice. At this stage, we see a major problem with the blurring of responsibilities within the regulations and the impact that will eventually have on taxpayers, consumers, trustees and members.

We have a major problem with the potential cost of compliance that will be imposed on the trustees and members. We have a concern about the complexity that will originate from the blurring of responsibilities. Even more importantly, we are worried that people will not get the right advice, because they will be getting blurred advice or fuzzy advice from different areas. There is no one single area where the trustees and members will be able to get the complete advice they need to run their small managed superannuation fund. That is basically because we see the tax and financial areas in the small managed superannuation fund as being dovetailed. You cannot have financial advice without having taxation advice, and that is what we see as the crux of the problem.

We are also very concerned about the independence and the lack of impartial advice that may flow, if it were to flow only from financial advisers. We are concerned about the fact that financial planners do not have to be totally qualified to be able to practise and give advice on financial planning products. Whereas a tax agent, on the other hand, or an accountant actually needs to be totally qualified, and if they are not they cannot operate in that area. As a tax agent you have to satisfy the requirements of section 251L of the Income Tax Act; otherwise you cannot practise as a tax agent. That means that you must be fully qualified and, even better, that you must have relevant experience to actually practise in that area.

One of the problems we see with the authorised representative approach is that it is an authority that can be withdrawn at the stroke of a pen. That can have a severe impact on the public who are relying on the advice of people who may have their livelihoods taken away if they are not pushing product, as we have heard from previous submissions. I mention here that that has actually happened twice to our executive director, Barbara Smith. She does not practise in the financial planning field but, because of the nature of the service that we provide, she needs to be an authorised representative. Because she was not pushing product, as I said, twice she has had her authorised representative status withdrawn. If that can happen to someone in her position, then, I think it does not go well for maintaining that independence and impartial advice that we see as being so dear.

You do not have a similar operation or process for licensed tax agents. Your licence cannot be withdrawn, except by the Tax Agents Board, and then it can only be withdrawn where you have a fairly grave transgression. There is no stroke of a pen. While you are a fit and proper person, while you maintain your credentials and while you maintain your continuing education, you are allowed to continue as a practising tax agent.

As I said at the outset, we are very concerned about the blurring of tax agent advice and financial planning advice. It is ironic, I suppose, that we find that the regulations—and I think it is in subsection (4) of 7.1.29—allow financial planners the right to give a disclaimer in terms of the financial planning advice that is contained in any advice that they give, but there is no such reciprocal process for financial planners who may in fact be giving taxation advice. This is where we see a real dichotomy. The trustees and members of superannuation funds may in fact be lured into making bad decisions simply because they are relying on advice that may not be correct. At the end of the day, if a trustee or a member of a small superannuation fund is going to get it right, they will need to have both their financial planner and their tax agent sitting opposite them so they can bounce all the ideas off them, because you have in effect a situation where the financial planner cannot give taxation advice and the tax agent cannot give financial advice. You actually need both of them there to make sure you end up getting the right advice in terms of the

product on an ongoing basis. I think I will leave it there. That basically covers our position as far as our submission goes.

Senator CONROY—In your submission, you raise the concern that consumer protection is not enhanced. I think you have addressed that a little bit in your opening statement, but I want to go back to the particular paragraph, which says:

> ... if the integrity of SMSFs is compromised by a plethora of AFSL holders keen to access the SMSF gravy train and aggressively targeting this potential new business, with the main game being the ensuing commissions and trails that flow from the investment products sold.

Can you explain to me how this gravy train is created?

Mr McDonald—First of all, I would like to say that I did not write the submission, so I will be drawing on my understanding of where the author came from. Her concern was very much that the push for trailing commissions is such that financial advice will push you down a certain path. To use your own words, in the earlier discussions I think you were talking about a continuous nine per cent that will be flowing into the fund. A huge amount of money will be flowing into these small superannuation funds. There is a gravy train there for someone who can get in there, give appropriate financial advice and have the trailing commissions flowing back in a regular manner. Part of the problem that we see with small superannuation funds is that they are not necessarily totally driven by financial needs. A lot of it is actually driven by taxation needs as well. I think you have to understand that the SMSF market is basically made up of small businesses. As part of their self-managed superannuation fund, they are looking to manage their entire business operations together with their potential retirement strategies. That entails locking up their business plans for their normal business with where they structured their business and real property, and that in turn will ultimately lead them to their final retirement destination. In the meantime, most of the decisions that they make are very much tax driven.

Senator CONROY—Your argument appears to be based on the assumption that only financial planners will qualify to be able to provide this advice rather than accountants taking out a licence to provide this advice. Presumably you do not have the same fear if an accountant is going down this path?

Mr McDonald—We do not actually think that is correct. I envisage that a lot of accountants will in fact go down the licensing path, but there will be a lot who decide, 'No, this is a very small part of my business structure; it is just not worth my while to go down that path,' especially if you are going to have of the order of $10,000 or $12,000 in annual fees to maintain that licence. But their clients still fit into the category where they are looking for the advice that I mentioned earlier. They are going to be placed in the position where the client is going to be looking for what I would term taxation advice but what the new regulations and the new regime see as financial advice.

I would have thought that the financial advisory product was quite clear in terms of what it was, but when I read the explanatory memorandum that accompanies the regulations, I become very confused as to what is taxation advice and what is financial advisory advice. That in fact is where the problem lies as far as we are concerned. I think there has been a real blurring of what is the traditional tax area and what is the appropriate financial planning area. At the end of the day, what we would ultimately like to see is that blurring eliminated so that everybody knows

quite clearly where the delineation lies, so you can appropriately give tax advice and financial advice and you may not be caught in that grey no-man's-land.

CHAIRMAN—Do you accept the distinction that the accountant groups drew earlier between advising on the vehicle or the structure for superannuation and advising on the investments that the structure ultimately makes? Do you accept that as a valid dividing line between who should be required to be licensed and who should not?

Mr McDonald—My personal view is that the structure is not a financial product at all, but quite clearly the law sees it differently. From that perspective, we either completely change the law to eliminate the superannuation structures out of the process or that is a given and we just have to work within it. We have come from the position that we know that it is a given. We do not believe that the government is going to back away from that position. Now it is a matter of making that work. We see that there is a blurring of the distinction between what is tax advice and what is financial advice. We need to correct that blurring. If we can do that, then we are going to eliminate a lot of the problems that are going to flow to the trustees and the members. At the end of the day, they are the ones that are going to bear the cost.

CHAIRMAN—How would you eliminate that blurring in terms of the issue that we are discussing tonight: the advice on the structure?

Mr McDonald—The structure is a different issue entirely. You have to go right back to your building blocks if you want to correct the problem with the structure. What I think you do need to do is go back and revisit the explanatory memorandum and to carve out those areas that are quite clearly taxation advice issues. Things like the movement from the accumulation phase into the growth phase and the pension phase is really nothing more than a tax advice issue. From my own personal perspective, the structure itself is nothing more than a tax issue, as is the setting up of a company, a trust or a partnership. They are just tax issues.

CHAIRMAN—So that is the way you would deal with it—define advice on the structure as being a tax advice issue?

Mr McDonald—Absolutely. Under section 251L, we have registered tax agents who are entitled to give taxation advice under one regulatory regime and yet under a completely separate regime we have another set of rules that says, 'You cannot because we consider it to be financial planning advice.' It has to be one or the other. The left hand has to know what the right hand is doing. That is where I see the problem. That is what we have to fix up.

Senator WONG—I am sorry. Perhaps I misunderstand your submission, Mr McDonald. I thought what your submission was saying was that you accept that there should be a licence under FSR even for the structure. Your submission says:

... a clear distinction has to be made between a licensed person recommending a SMSF as a suitable vehicle … (and therefore regulated by ASIC), and a "SMSF Adviser/Specialist" who proposes to take on the role of the SMSF Trustee in all but name ...

Mr McDonald—I was responding to Senator Chapman's question. He asked me what my opinion was and I have given him my opinion. Our position is that we do not believe that the

government is going to change its view on the issue of structures. From that perspective, it remains as is. Now what we want to do is fix up that blurring.

Senator WONG—You want additional skills to be required of people who advise on investment decisions being taken by SMSFs. Is that right?

Mr McDonald—At the end of the day, the best way for this whole industry to move forward is to raise the bar, not lower the bar. I am not sure that we have actually achieved that with the process that you have put in place in terms of the FSR regime. I would love to see—and this is just a personal view of my own—financial planning and taxation advice almost being merged together. You would have a situation where you had people that had not only accounting skills but financial planning skills, who could create the very thing that I think you are trying to create but not getting it very right.

Senator CONROY—Do you think that somebody who is an expert in tax advice is automatically an expert in investment advice?

Mr McDonald—No, and I do not believe that anyone who is an expert in financial advice is an expert in tax advice. Therein lies the problem.

Senator CONROY—You heard some of our discussion earlier—and you seemed to argue it again from Senator Wong's quote—about this vehicle concept. I guess I am challenging previous witnesses and you on the idea that, in respect of this trust vehicle alternative, a discretionary decision is made to put funds into it whereas with superannuation it is not a discretionary decision. It could be argued that that is the case after convincing them to open a self-managed fund, in that they may go off and put it somewhere else; that is certainly within the realms of possibility. But it is a vehicle that becomes a long-term investment that has a whole range of requirements. For example, it has to be kept until a certain point; it is there for a specific purpose and it receives a tax exempt or tax reduction status. It is a certain thing designed to achieve a certain policy aim at the end whereas with a trust it is a discretionary issue as to whether you put money into it or not, based on a different set of decision making processes. While they are both empty vehicles the moment they are created, one of them is guaranteed to be filled up while there other is not necessarily guaranteed to be filled up. The public policy purpose of superannuation is very specific. You heard me have that argument with the previous witnesses; do you still maintain that you believe that they are the same empty vehicle and that they are just a piece of paper?

Mr McDonald—My personal view is yes, but I am not sure that we are achieving anything by arguing that particular case. We have come from the perspective that that is the way it is going to work so let us just accept that, move on and create a system that will actually work given what we see as the other problems with the process. In a roundabout way, that is what my colleagues in the accounting profession were trying to say. They were just using slightly different words from the ones I used.

CHAIRMAN—Nevertheless, you are saying that the advice on the structure should be carved out of financial product advice, aren't you?

Mr McDonald—I think we have to sit down and work out precisely what is the taxation advice and what is the financial advice. That is where the issues are blurred at this stage.

Senator WONG—So what do you say about the advice as to which structure of superannuation someone should turn to? Do you say that should be for a licensed person to give advice on?

Mr McDonald—Are you asking for my personal opinion or for the position of the association?

Senator WONG—The association.

Mr McDonald—The association says that that is a non-debatable issue. We are not going to argue it. The law already exists and it is in the definition. We are not going to beat our heads against a brick wall and achieve nothing.

CHAIRMAN—With due respect, Mr McDonald, to a large degree this inquiry is about that very point and whether that should be the case or not, and whether we recommend that it should be changed.

Mr McDonald—On that basis, we would say that it really is nothing more than taxation advice.

Senator WONG—So you think that there would be no benefit in requiring people who give that advice to be appropriately licensed?

Mr McDonald—No. I must admit that I really fail to see how they gain or lose anything on that particular issue. As far as the investment of funds into the fund goes, I have absolutely no problem with licensing requirements at that point.

Senator WONG—And you are suggesting that they should not only be licensed, but also have taxation qualifications.

Mr McDonald—The problem with these sorts of products is that taxation advice is inextricably linked to financial advice. You cannot do an evaluation of the financial product without understanding the taxation implications. You have to come back and give the client financial advice and also taxation advice.

Senator WONG—So you are suggesting an additional level of qualification for the current licence?

Mr McDonald—You either go one of two ways—

Senator WONG—Did I get that right?

Mr McDonald—At the end of the day it may be the only alternative, yes.

Senator WONG—Thank you.

Senator CONROY—You raised the issue of additional and voluntary contributions to a super fund. Your submission states that this example does not distinguish between a decision to make additional contributions and choosing which vehicle should be used. Could you take me through the concerns there?

Mr McDonald—As I have said, SMSF funds are predominantly governed by small business. At the end of the day, small business would find itself having to deal with potentially a large taxation problem. Invariably they have made too much money and they really do not want to pay income tax on it. I am being quite blunt here. One of the planning techniques of getting around that problem is to make extra contributions into your superannuation fund. It is an outright deduction to the business structure and it just flows into the fund as additional and assessable contributions into that fund.

Senator CONROY—As you said, that was very blunt.

CHAIRMAN—It is subject to the effects of the levy.

Mr McDonald—Of course. They will pay tax going into the fund, and the surcharge may be applicable, but that is all part and parcel of what I would see as the tax planning process—nothing more, nothing less.

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

[9.21 p.m.]

GREENTREE-WHITE, Mr James, Lawyer, Legal and Policy, Law Council of Australia

SIMMONS, Ms Lisa, Representative, Law Council of Australia

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public but if at any stage you wish to give part of your evidence in private you may request that of the committee and we will consider such request to move into camera. We have before us the written submission from the Law Council. Are there any alterations or additions you require to make to that submission?

Mr Greentree-White—No.

CHAIRMAN—I now invite you to make a brief opening statement, at the conclusion of which we will move to questions.

Mr Greentree-White—Firstly, I would like to record the Law Council's thanks for the opportunity to appear this evening. We appear at short notice and we acknowledge that our submission was provided to you only today. Given the circumstances, we are very grateful for this opportunity. As members of the committee would be aware, the Law Council of Australia is the peak national body representing the Australian legal profession. It represents approximately 36,000 lawyers through the member organisations, the law societies and bar associations, which belong to the Law Council.

For some time Australian lawyers have had concern about the Financial Services Reform Act and its implications for the provision of legal advice and legal services to the Australian community. As the committee would be aware, the Law Council made representations on the Financial Services Reform Act. The broad thrust of our concern has been that, while the Law Council supports what it understands as the objective of the Financial Services Reform Act to improve the regulation of core players—central players—in the financial services industry, when lawyers are engaged in their ordinary legal practice they are involved in activities that put them on the periphery of that industry, given the existing regulatory system for lawyers through the states and territories—that lawyers should not be subject to double regulation for their ordinary legal practice.

To deal with this issue, the Law Council has established an ad hoc working group which is formulating its responses on the issue and is looking towards representations that may need to be made to Treasury and to ASIC. This specialist group consists of lawyers involved with the financial services area. One of the members of that group is Ms Lisa Simmons. She is a partner at the law firm Corrs Chambers Westgarth and she works in the financial services area. Ms Simmons drafted the submission that was provided today. I now hand over to Ms Simmons to speak directly to our submission.

Ms Simmons—Thank you. I guess it might come as a surprise that we welcome regulation 7.1.29. We think that that this will aid lawyers insofar as the previous exemption available to

lawyers with respect to their conduct only went so far as exempting them from the requirement to hold a licence where the advice being provided was provided by the lawyer in his or her capacity about matters of law, legal interpretation or the application of the law to certain facts, or was other advice provided by a lawyer in the ordinary course of activities of the lawyer and was reasonably regarded as a necessary part of those activities. That exemption is already set out in the act in section 766B(5). We welcome regulation 7.1.29 because there are other activities undertaken by lawyers which may not constitute advice but are in the ordinary course of the activities of those lawyers and reasonably necessary to those activities. Therefore, consistent with parliament's recognition that there is a need to balance the costs of lawyers being required to hold Australian financial services licences and the benefits of them doing that, there should be some consideration to ensuring that those really marginal activities do not fall within the provisions requiring the holding of a licence.

There are two particular financial services which lawyers may, from time to time, cross. One is that they may be dealing in financial products by arranging deals in financial products in connection with the activities that they undertake as lawyers. As you would be aware, the concept of arranging in the law is a very wide concept. While there is not any explanation in the law as to what it means, ASIC has published some guidance as to what it considers to be arranging. ASIC has indicated that arranging refers to the process by which a person negotiates for, or brings into effect, a dealing in a financial product. The second financial service with which lawyers are concerned is custodial or depository services. The definition of custodial or depository services in the act requires little more than that a person be holding a financial product on trust for or on behalf of another. This can occur in the course of a lawyer's ordinary activities as a lawyer, and some careful consideration needs to be given to ensuring that those ordinary activities do not fall within the financial services licensing regime. That probably covers that point.

In the submission, there is little suggestion of a need for changes to the drafting of regulation 7.1.29. However, we do have a concern about the requirement that an eligible service for which the regulation provides exemption be both reasonably necessary to and an integral part of the exempt services which are described in that provision. We can understand why a service must be reasonably necessary to an exempt service to have the benefit of the exemptions granted by that regulation, but we do have some questions about the additional requirement that the service also be integral to that exempt service. In our submission, we have discussed the circumstances in which we see that there may be satisfaction of the 'reasonably necessary' test but possibly not the 'integral part of' test. That is addressed particularly in paragraphs 20 and 21 of our submission. The example which we have given in discussing that particular provision is the work that a lawyer may undertake in acting on an acquisition of a company. The lawyer may provide advice on, for instance, due diligence issues, terms of the contract for acquisition of shares, regulatory approvals which may be required and possibly tax issues. It is clear that that advice will fall within the existing exemption in 766B(5). However, in the context of the matter, the lawyer may also be required to negotiate and draft contracts, execute the acquisition of the contracts as attorney for the client and possibly receive, hold and temporarily invest consideration received for the acquisition which is paid to the lawyer by his or her client. As we say in paragraph 21, it may be reasonably easy to conclude that those services are unnecessary to the provision of the advice and would therefore fall within the provision 7.1.29(3)(c).

Senator WONG—The investment of the consideration is presumably at the direction of the client?

Ms Simmons—Yes, you would expect it to be the case that it would be at the direction of the client.

Senator WONG—If it were so, do you have concerns that the regulation would not accept that?

Ms Simmons—Yes. That it be done at the direction of the client is not one of the exempting—

Senator WONG—If the lawyer is not providing advice as to that investment, why would that be caught?

Ms Simmons—It is the act.

Senator WONG—Okay.

Ms Simmons—Advice is already carved out under 766B(5); it is the other acts with which lawyers are concerned. While we have looked at regulation 7.1.29 and gone, 'Hey that is great; that solves quite a lot of our concerns', it just does not quite cover all of them. Moving on, we have then put into the submission some comments, particularly on some of the eligible services as they are defined in regulation 7.1.29. Probably the main one that is worthy of note is the wording of subparagraph 7.1.29(3)(c), which concerns advice on acquisitions and disposals of incorporated or unincorporated entities. The manner in which that subparagraph is worded suggests that advice on acquisition or disposal will be an eligible service only if the advice relates to the acquisition of the whole entity rather than of the part. One wonders how you would apply it if, for instance, the client was proposing to acquire or dispose of 20 per cent or 25 per cent of a particular entity.

In a couple of paragraphs that follow, we have noted some fairly minor drafting points. In fact, I will not even take you through the remaining paragraphs of that because the changes that we have suggested or discussed are either the same sorts of issues that have already been addressed in connection with superannuation funds in the other discussions or are a note that, in regulation paragraph 7.1.29(4), there seems to be a requirement that the tax adviser not earn any commission from the advice that is given. Given that there may be the ability to refer a person to another holder of an Australian financial services licence and earn commissions from that referral, that is covered by corporations regulation 7.6.01(1)(e) and 7.6.01(1)(ea). It seems a little unusual to have a requirement that a tax adviser not earn commission to take advantage of that particular exception.

Probably the biggest concerns of the Law Council are addressed in the final part of the submission, which concern matters that are undertaken in the ordinary course of the activities as lawyers but do not seem to have been dealt with in any of the regulations or provisions of the act that have been included so far. The principal one which we have been working on as part of the ad hoc working group has been holding and dealing with trust money and controlled money. When money is received by lawyers in connection with their practice, it is either paid into a general trust account in an approved financial institution and held as required by law—that is

trust money—or paid otherwise than into a general trust account as directed by the client and held as required by law—which is controlled money. There is also a third category of money which we do not have any particular concerns about, and that is money in transit where money is paid or delivered to a third party free of the lawyer's control as directed by the client. In the case of trust money or controlled money, on our analysis of the custodial or depository service definition, there is actually a very good argument that a lawyer is providing a custodial or depository service. Many of our concerns in this regard will be dealt with if the draft regulations that were released for comment on 11 March make it through parliament. I am not sure what is happening with those at the moment except that they do not appear to have moved along since they were in consultation. The relevant regulation provides a proposed regulation provided that a financial product held by a provider which is a basic deposit product would not constitute the provision of a custodial or depository service.

There is one concern that we do continue to have, and will continue to have, notwithstanding the enactment of the draft regulations. It is that, if the money received by the lawyer is paid into another financial product, such as a cash management trust, that activity and the holding of that financial product by the lawyer for the client will constitute a custodial depository service requiring the lawyer to have a financial services licence. There does not seem to us to be any good policy basis for drawing a distinction, so we are going to suggest in submissions that we will make to Treasury that there be an exception in the law to permit a lawyer to invest money into cash management trusts on behalf of a client.

The second instance of concern is where lawyers are appointed by their clients to act as attorney. This is quite a common thing, and the attorneys that are granted may be quite specific or they may be more general. This would be part of the ordinary business of a lawyer and it is more convenient for clients to appoint their lawyers as attorney than other persons. Given that any default in this area by lawyers would be covered by lawyers' fidelity funds and mandatory insurance, we would consider there to be good policy grounds for also exempting this activity.

Lawyers are often asked by their clients to arrange sales of securities. Under the old law, if you enacted a transaction on behalf of a client through somebody who held a licence, there was no regulatory concern arising, but there is no equivalent provision under the new law. So, again, we will be looking to approach Treasury about getting an exception for that type of instruction given to a lawyer.

One of the other larger areas of concern arises from a lawyer acting as an executor or trustee in respect of a deceased's estate. Where the lawyer is acting as an executor, it is our understanding that the lawyer will have full ownership of any property received, so there should not be custodial or depository services issues. Similarly, any dealing by the executor with financial products should not give rise to the provision of a financial service, since the executor should have the benefit of the dealing on own account exemption. However, quite frequently after the role of executing an estate is completed, the lawyer will move into the role of trustee. It is at that point that there will again be problems for lawyers, who will be providing both custodial and depository services and who will also be dealing in financial products when they dispose of those financial products to creditors, beneficiaries or others.

Finally, there are also instances where lawyers arrange cover notes of insurance, particularly for conveyancing clients, as part of a conveyancing transaction. It is my understanding, although

I am not a conveyancing lawyer myself, that these insurance cover notes are regularly taken out by lawyers for their clients, and that a failure to do so would ordinarily amount to professional negligence. Of course, if a lawyer arranges a cover note for a client, that will be dealing in a financial product—being the general insurance product—on behalf of the client. We would also be looking for lawyers to obtain an exception to permit them to obtain that cover note protection for their clients.

Senator CONROY—Paragraph 29 of your submission, in relation to advice on the different superannuation structures, states:

Even in circumstances where the advice is deliberately framed so as to avoid making an express recommendation as to the best course of action for the client, it is likely to be the case that an implicit recommendation is given.

I think that is absolutely the intent of the law. You have already been subjected to harangues on structures and vehicles and those sorts of things, when listening to the other witnesses. Do you disagree that recommending a superannuation vehicle of any sort is investment advice?

Ms Simmons—If it were possible to give advice that was only about the structure, you may be able to avoid an argument that you were, in fact, advising on the financial product or a class of financial products, but I think it would be nearly impossible to do.

Senator CONROY—The law is well framed, then?

Ms Simmons—It is very wide.

Senator CONROY—I think I will rest my case there—I think I won!

Ms Simmons—The law is definitely framed sufficiently widely to capture that. Personally, I think that relying upon some sort of factual information-only exemption is actually quite difficult.

CHAIRMAN—If lawyers were asked to advise on the same thing, what would be the position for lawyers?

Ms Simmons—766B(5). Provided it is within the ordinary activities of a lawyer and reasonably necessary to those activities or is advice on the law, the interpretation of the law or the application of the law to facts, then the lawyer would be exempt.

CHAIRMAN—So there is a clear difference there between lawyers and accountants?

Ms Simmons—A clear difference.

CHAIRMAN—Why should that be? Why should lawyers get preference over accountants?

Senator CONROY—I love watching a catfight between the professions.

Ms Simmons—There has always been a distinction drawn between lawyers and accountants.

CHAIRMAN—I do not regard that as a satisfactory answer. Why should there be? Just because it has been there in the past does not mean it should continue into the future.

Ms Simmons—No, I agree. But lawyers do have special fiduciary duties that they owe to their clients, and there has been a body of law built up around the fact that lawyers have duties to avoid conflicts of interest, that they have duties to avoid breaches of confidentiality. The fact that there is legal professional privilege and not accountancy professional privilege is also indicative of the fact that there is a distinction to be drawn between lawyers and accountants.

Mr Greentree-White—Lawyers are also subject to a regulatory regime in the states and territories under the legal profession acts. There are mandatory professional indemnity insurance requirements applying to lawyers. Lawyers have a special role as officers of the court. There are a number of reasons why the parliament saw fit to enact the exemption—

CHAIRMAN—Apart from the fact that there are a lot of lawyers in the parliament.

Mr Greentree-White—in relation to legal advice when they considered the Financial Services Reform Act.

Senator CONROY—The fact that they successfully lobbied your entire frontbench is a credit to them, Grant, not something for you to make fun of them about!

CHAIRMAN—You raised the issue of the officers of the court, but, apart from that issue, a lot of those other provisions apply to accountants as well, don't they?

Ms Simmons—I do not know.

Senator CONROY—But do any of those things you described qualify you in any way to make recommendations to a client about which superannuation vehicle to put $50,000 into?

Senator WONG—Or are you arguing you should be able to do that?

CHAIRMAN—Yes—you said they are exempt.

Senator CONROY—She said they are exempt because they are exempt.

Ms Simmons—To the extent that what we do is within the ordinary activities of a lawyer, and reasonably necessary to those activities, I do not think that would entitle a lawyer to start telling clients where to invest their money. I think we are talking about something different.

Senator CONROY—But you have an exemption at the moment to allow you to do that.

Ms Simmons—For advice.

CHAIRMAN—You have an exemption to do that, whereas accountants do not have an exemption for things that accountants might do in the normal course of their activities.

Ms Simmons—That is right.

CHAIRMAN—It seems an inconsistency to me.

Senator CONROY—You seem to think, though, that you are captured on superannuation vehicles rather than other incidentals. I am just trying to understand.

Ms Simmons—The distinction for lawyers, and why we look to 7.1.29 and go, 'This is better than nothing,' is that there are other activities that are undertaken by lawyers that would not amount to advice. If you were establishing a superannuation fund and you were drafting up the documentation, drafting up the applications and preparing the board minutes—all those activities that you may undertake in setting up the fund—there is an argument that what you are doing is arranging a deal in a financial product. It is for that that we are looking to 7.1.29 for comfort.

Senator CONROY—So you are exempt on almost all financial advice, as per the existing situation, but on superannuation structures you think you might be caught and you are seeking to be exempt from that as well. Is that essentially what you are looking for?

Ms Simmons—What we are looking for is to ensure that the ordinary activities of lawyers that are undertaken in the ordinary course and that are reasonably necessary for the performance of those functions are not caught by the licensing regime, whether they are advice, whether they are arranging or whether they are the provision of a custodial or depository service.

Senator CONROY—But you have no special qualifications within your law degree or any of your professional qualifications that give you any insights into the investment market?

Ms Simmons—No, not personally.

Mr Greentree-White—It is important to note that the exemption in section 766B(5) of the Corporations Act is in relation to what would otherwise be financial product advice if it was incidental to the ordinary legal practice. It is not financial product advice in itself being done for its own sake. The Law Council has said consistently that, if lawyers were being central core players in the financial services industry, they should be subject to the licensing requirements. Where it is incidental to their ordinary legal practice, we believe they should be exempt so that there will not be an extra layer of regulations in addition to the regulations which lawyers already have.

Senator CONROY—Is that what real estate agents say?

Mr Greentree-White—I cannot speak for real estate agents.

CHAIRMAN—Or for the accountants concerned.

Senator CONROY—That is what experts have been saying.

Ms Simmons—The approach that they took in the UK, when they developed the Financial Services and Markets Act, is interesting. To read the words of an exemption they have put in, you might think that someone drafting the law here had a good look at it as well. It says that

activities which are 'carried on in the course of carrying on any profession or business which does not otherwise consist of regulated activities', being financial services, 'may reasonably be regarded as a necessary part of other services provided in the course of that profession or business'. It is basically not just advice but the provision of a financial service. There are a number of paragraphs that are referred to in the relevant exemption, but the ones that were of interest to me concerned the fact that they carve out arranging and custody.

Senator CONROY—As a percentage, I think there are more lawyers per head in the British parliament than in the Australian one.

Ms Simmons—It is probably why they do such a wonderful job.

Senator WONG—I would like to go back to the exempt service issue you raised. This is at the two dot points at paragraph 20. Your concerns were that that would not be caught in the exempt service definition—is that right?

Ms Simmons—That is exactly right. I think the 'an integral part of' test is actually quite a hard one to satisfy. The way the regulation in 7.1.29(3)(c) is framed, it refers to the fact that it is advice being provided. So for anything that you do that is not advice, you would query how that could be an integral part of the advice that is being provided. For instance, if you are executing the contract or you are providing some other sort of service, it is very difficult to see how that could be an integral part of advice.

Senator WONG—Has this issue been raised?

Ms Simmons—I think I might have seen it in somebody else's submission, but no, it has not always been—

Senator WONG—The other issue you raised was at paragraph (3)(c) of advising on the acquisition et cetera. You were making the point—I think it was probably a reasonable one—that acquisition of a part of an entity might not be covered.

Ms Simmons—That is right. It is just that, where so much care has been used in framing other regulations to make a distinction between an interest in something versus the whole entity, it is hard to read that as only applying to a part of it.

CHAIRMAN—There being no further questions, I thank both of you for appearing before the committee and for the evidence you have given us today.

[9.53 p.m.]

ROSSER, Mr Michael John, Manager, Investor Protection Unit, Corporations and Financial Services Division, Department of the Treasury

YIK, Mr Andrew Yu Chin, Analyst, Department of the Treasury

CHAIRMAN—I welcome the representatives of the Department of the Treasury.

Senator CONROY—I have a couple of questions—relatively boring ones. The first issue I would like to raise is one that the Australian Bankers Association, ABA, referred to in their submission—that is, a review of the regulations is required once they have been put into practice. Is Treasury planning to conduct a review of the FSRA post implementation?

Mr Rosser—No decision has been taken on that, Senator.

Senator CONROY—In their submission, the ABA states that up until 31 May 2003 only about 1,000 of the expected 6,000 licensed applications had actually been received. Are you concerned as to whether ASIC will be able to process all the applications, as it would seem they will all be coming in at the last minute?

Mr Rosser—ASIC has indicated that it has a preference for people to lodge their applications early. I think you might need to address that question to ASIC.

Senator CONROY—The CUSCAL submission states that a number of outstanding matters need to be addressed, such as ASIC's policy statement on conduct and disclosure, financial product advisers, amendments foreshadowed by Treasury to fix unintended consequences identified by industry and a policy decision on compensation arrangements. Could you advise the committee on the status of those outstanding matters?

Mr Rosser—On the compensation matter, the government is developing a paper for public consultation on compensation arrangements in the financial sector. It has yet to be released. In regard to the development of regulations and legislation, as you probably know, a number of packages of regulation have been released for public consultation and a number of regulations have been gazetted. The government has announced that an amendment bill will be introduced into parliament in the future.

Senator CONROY—In regard to regulation 7.1.29, the original draft of the regulation gave accountants a specific exemption for providing certain advice whereas the current regulation applies to everybody. What groups do you anticipate that this regulation will cover aside from accountants?

Mr Rosser—Let me explain the background to that approach. The basic operation of FSR, the financial services reform legislation, is based on activities—a functional approach to regulation. So it takes an approach that says that if advice, dealing or whatever is provided by a person, then that advice, dealing or whatever should be regulated equivalently, not having regard to the

professional group that is providing that service. In that regard, when the process of developing this regulation was commenced, the approach was essentially to identify the activities which should not be FSR regulated. Therefore, it was not a question of who performed those activities and whether they should be regulated or otherwise but rather whether the activities should be regulated or not.

CHAIRMAN—Why do lawyers still get a special exemption?

Mr Rosser—I think you are asking me to comment on government policy, so I respectfully decline.

CHAIRMAN—Hear, hear!

Senator CONROY—I think you have already heard discussion a few times about this issue of a superannuation vehicle, so I will not take you through that. I want to clarify the issue in relation to broad asset allocation advice. Regulation 7.1.33A provides for the general exemption for what is generally known as broad asset allocation advice—that is, relief is provided where the advice relates to the allocation of funds that are available for investment in shares, debentures, stocks or bonds, deposit products, managed investment products, and so on. I am sure you are familiar with it. If a person can advise their client on different asset classes without needing to be licensed, doesn't the same argument apply to advisers like accountants who want to advise their clients on the class of super structure which is most suitable for them?

Mr Rosser—I think it is a matter of degree. It is a question of how far the advice can go before it becomes financial product advice and of the appropriate demarcation between advice of a general nature and advice specifically tailored to a person's circumstances.

CHAIRMAN—Where is the line drawn?

Senator CONROY—Where the regulation says!

Mr Rosser—In the regulation we are discussing tonight.

Senator CONROY—Can you explain to the committee the purpose of regulation 7.1.33D relating to investment-linked life insurance products?

Mr Rosser—It is a new regulation. I would need to look that one up.

Senator CONROY—Please do not just read to us the explanatory memorandum. We have been there and done that.

Mr Rosser—I believe that regulation falls outside the scope of this inquiry. I will stand to be corrected.

Senator CONROY—It may be that I have just bundled them all up together. It is in No. 85.

Mr Rosser—The rationale for this regulation is that the way the legislation is framed, the operation of the 'making a market' provisions which require licensing can inadvertently capture

certain types of investment products that are provided where, each period, the offerer of the product has to provide a price at which it can be redeemed. That could constitute making a market, but the purpose of the regulation is to recognise that what it is doing is actually providing a service to the person to tell them what the value of that would be at a particular point in time. It is not about making generally available the willingness to form part of a making a market transaction. It is not a general offer to the public; it is actually in respect of a specific client.

Senator CONROY—Could you explain to the committee the purpose of regulation 7.6.01(1)(l), relating to non-cash payments?

Mr Rosser—If it is the one I think it is, it is in relation to—

Senator CONROY—I just want to know what type of transactions are being regulated.

Mr Rosser—It is a refinement of the provision that deals with the definition of what a non-cash payment is, to the extent of defining what types of products are subject to FSR licensing obligations. The definition that is in the legislation at the moment talks about a transaction where there is one party involved in the transaction, which gives rise to a difficulty when that party is in effect a joint party—that is, it is an account or facility that is held in the name of more than one person—as it means that, if it were held in the name of more than one person, it would not be subject to the exemption. So the refinement is to say that one party can include a jointly held product.

Senator CONROY—Could you explain to the committee the purpose of regulation 12.7.06, regarding the friendly societies code?

Mr Yik—That was a transitional amendment as part of coming into the FSR regime. The old schedule 4 applied to friendly societies. There was no method to disapply that provision, so that basically came into the new FSR regime. They had the old regime applying to them as well. All this regulation says is that you have only one regime applying to you—you do not need more than one: it is either FSR or the old schedule 4.

Senator CONROY—I would like to turn to Statutory Rules 2003 No. 31, starting with the funeral expenses policy. Could you advise the committee why the regulation exempts a funeral expenses policy from the definition of financial product under the act?

Mr Yik—Yes. It is a reflection of what was already there in the Life Insurance Act. Under the provision of the act, section 761 only talks about funeral benefit, which is the first half of the Life Insurance Act definition of what a funeral benefit generically is. Both parts of the Life Insurance Act exemption were not carried through to FSR, because we were not sure whether you could be certain that the money that you are paying up, which is reflected in the regulation, would actually be for a funeral. There was a great anti-avoidance potential there. We have corrected that by basically adopting what is in the Life Insurance Act, but including anti-avoidance measures such as ‘only’ and ‘solely’, so that means you can prepay money for a funeral. However, it must be solely for the purpose of a funeral.

Senator CONROY—So they really were trying to take it with them!

Mr Yik—Yes.

Senator CONROY—In terms of a funeral expenses policy, a person who is making a periodic payment over a certain length of time is making an investment in a specific individual product, as you defined it, but it is an investment product?

Mr Rosser—Another way of looking at it is that it is a prepayment of an expected liability. That liability is in relation to the funeral expenses only, so there is no investment return. The benefit is the provision of the service.

Senator CONROY—A shiny coffin.

Mr Yik—It is the shiny coffin you want.

Senator CONROY—Okay, I will pay the 'no benefit'. Under amendments to regulations 7.1.11 to 7.1.17, product providers can provide a PDS in relation to some insurance covers and not others. Can you advise of the circumstances when insurers can unbundle these insurance contracts and provide a PDS for some insurance covers and not others?

Mr Rosser—The difficulty being addressed by these regulations is that some insurance policies provide a range of covers. Some of those covers would be defined as retail covers underneath FSR and some would not. But there is a technical issue about whether or not, because there are retail covers being provided, a PDS would have to be provided in relation to all of the covers. So what the regulations attempt to do is to allow insurance—

Senator CONROY—To capture the retail.

Mr Rosser—In a sense, to not require them to unbundle them—they can present them in the form that they think is preferable, but it ensures that the PDS obligation still applies to the retail products.

Senator CONROY—Subregulation 7.7.02(4) provides relief from the obligation to provide an FSG under section 941C(8). The explanatory memorandum says that the provision is able to be used when conducting marketing activities for existing and prospective clients. Can you advise the committee why FSG would not be required in those circumstances and what the client receives instead of the FSG?

Mr Rosser—These are situations which are basically analogous to the public forum exemption—for example, when you have a billboard posted somewhere—but they apply to mass-marketed mail and email schemes. Only general advice is provided; no personal advice is provided. This is a product that is not geared to you; it is just a product that is out there. It is subject to several conditions in terms of being able to provide this without an FSG. Firstly, you must say who it is that you are dealing with. Secondly, you must deal with any risks that may be applied and with the significant benefits also. It is basically taking some parts of the disclosure regime and saying that you have to provide a full FSG—you have to provide the relevant components of it in relation to the particular product.

Senator WONG—Where are those relevant components set out? Is that provided by the reference to section 949A in relation to general advice warnings in the regulation?

Mr Yik—It is subject to 942B(2)(a), (e) and (f), which are those statements setting out the name and contact details of the providing entity. It is information about remuneration including commissions or any benefits that the providing entity or relating body corporate of the providing entity, directors or so forth are able to achieve, and also information about any associations or relationships between the providing entity and those that might be reasonably expected to provide the service.

Senator WONG—Are you reading from section 942A and B—is that right?

Mr Yik—942B(2)(a), (e) and (f) as provided under the regulation.

Senator WONG—Where is that referred to in the regulation?

Mr Yik—Regulation 7.7.02(4) subsections 4 and 5.

Senator WONG—I might have lost some of this in the photocopying.

Mr Yik—Also the other restriction is that you cannot provide general advice without an FSG—you cannot do it in a situation where there is a telephone call or a meeting.

Senator WONG—Yes.

Senator CONROY—I welcome the regulation to prescribe certain other public holidays for the purposes of hawking. While it was a hard fought win from Senator Campbell, I am just trying to recollect the debate on the floor of parliament and whether or not the government gave a commitment to restrict further the hours available per day. Are you familiar with that debate?

Mr Rosser—I was in the chamber at the time. I recall that the commitment was in relation to days not hours. It was about public holidays and I think the debate quoted Anzac Day, for example.

Senator CONROY—Yes. Are you happy for your wife to be receiving phone calls about insurance policies at 9 o'clock on a Saturday night?

Mr Rosser—Senator, you are asking me for a personal opinion.

Senator CONROY—I am. I guess that is government policy, so I will not waste your time on it. Under the subregulation 10.2.38(2)—the insurance brokers registered under the relevant insurance act—persons now hold a licence authorisation issued by APRA and persons who are licensed by ASIC or registered under the Insurance (Agents and Brokers) Act prior to the FSR commencement now carry on activities not previously subject to ASIC licence or registration and are eligible to make a streamlined application in respect of all activities. Given that some of these activities were not licensed under the old regime, why are you allowing these entities to access streamlined licensing? I am concerned that there are areas that were not previously captured.

Mr Rosser—The activities involved were subject to regulation through the Insurance (Agents and Brokers) Act. So the people who are subject to the streamlining provision were regulated people.

Senator CONROY—But some of their activities were not—is that your understanding?

Mr Rosser—Depending on whether the person is a broker or an agent, the Insurance (Agents and Brokers) Act applies differently. If the person is a broker, they would need to be registered under the Insurance (Agents and Brokers) Act. If they are an agent, then the insurance company for whom they acted would be subject to the regulation and would be liable for their activities.

Senator CONROY—Regulation 10.2.44A expands the range of documents which are exempt from having an AFSL. Can you confirm that persons are able to issue documents without the AFSL number until 11 March 2004, but after that date the AFSL number would be required?

Mr Rosser—At the moment there is a transitional regulation which relieves the obligation to put licence numbers on documents until end of the transitional period. There is an issue here that until the person is licensed they will not know what their licence number is, so they are unable to physically to put the licence number on documents.

Senator CONROY—I was wanting to make sure that after 2004 they will have to.

Senator WONG—That is not in the regulation, is it?

Senator CONROY—The transition runs out; I am presuming that it is automatic that they must include it.

Mr Rosser—That is right. The regulation runs out so that will be a legal obligation.

CHAIRMAN—Regulation 7.1.29(5) says:

For this regulation, a person also provides an ***exempt service*** if:

(a) the person provides advice in relation to the establishment, operation, structuring or valuation of a superannuation fund ...

How is it determined that advising on the structure of a super fund does not come within the definition of structure?

Mr Rosser—The regulation attempts to draw a demarcation between activities relating to information and advice about the attributes of structures, when the line, if you like, is drawn at the point at which the person makes the recommendation or gives an opinion about the appropriateness of a particular structure to an individual circumstance. The basis for that is essentially that the decision about whether to establish a superannuation structure, entity or interest is a decision about retirement income and savings. It is very difficult to distinguish that—as has been demonstrated in the preceding testimony—from an investment decision. In fact, it is an investment decision.

CHAIRMAN—I think the evidence from the accountants does distinguish it.

Mr Rosser—With respect, the evidence says that they would prefer it if the demarcation was drawn slightly differently. The issue is whether or not the establishment of a superannuation interest is a decision of an investment character, and the regulation takes the position that it is.

Mr Yik—With regard to the term 'structuring', the regulation then allows a non-investment decision, which is more of the administration and assisting someone who is managing a superannuation fund, to be made and then to go about that the best way once the investment decision has been made.

CHAIRMAN—So you are really carving out this minute little piece. There is the whole process of the superannuation fund other than the actual investment decisions of what goes in it but all the what you might broadly call administrative aspects. In other words, you can point out the advantages and disadvantages of various types of structures and, once the structure is set up, you can advise on all the administration other than the investment decisions.

Mr Rosser—You are carving out the advice of whether you should get into it or not, basically.

CHAIRMAN—But having done that you cannot advise which of those might best fit the person's overall business structure.

Mr Rosser—Another way of looking at it is that, when making a decision on whether to establish a superannuation interest, there are alternatives that are available to a person. They might choose to establish instead a managed investment interest. There are advantages and disadvantages of each; there are alternatives. Leaving aside the superannuation guarantee arrangements where there is no discretion as to the saving, in the case of establishing a superannuation interest where a person is making a decision, they may well make an alternative decision—for example, a managed fund investment—or they might choose to pay off their mortgage. These are all alternatives. It is a question of whether or not one regulated group of people making certain recommendations but not being able to make recommendations or statements of opinion in relation to other things—for example, managed investment funds—is an appropriate way to structure the regulation.

CHAIRMAN—I can understand that the decision to set up a super fund as distinct from paying off your mortgage or investing in something else is an investment decision but, having decided that you want to set up a super fund, I would have thought that to seek advice on which super fund structure is the most appropriate for you should not come under that definition.

Mr Rosser—It is a question of where the boundary is. I would again make the point that confining it to superannuation is one issue, and there are a number of alternatives within the superannuation market. So the question you are asking is whether or not there should be a capacity to extend the exemption into that area, and it would be very difficult for the regulation to provide a clear dividing line of the sort you are contemplating.

CHAIRMAN—But we are doing it for lawyers across a whole range of activities.

Mr Rosser—That is government policy.

CHAIRMAN—It may well be government policy but it is obviously not beyond the wit of the regulators to be able to carve out those areas if the policy determines it to be so.

Senator CONROY—According to the Law Council, they have unsuccessfully carved it out.

CHAIRMAN—How do we overcome this issue of the fracturing of advice to small business people? They get most of their advice from their accountant but then, for the small piece of decision making they have to make about a superannuation fund, they have to go off to a financial adviser whom they would not use for any other purpose.

Mr Rosser—I think the first question is what is the appropriate regulation to apply to particular sorts of advice, and then industry structures will obviously follow from that and will adapt accordingly. If a person believes that they need comprehensive advice, then presumably they would seek out comprehensive advice from several providers.

CHAIRMAN—Have you made any assessment of the cost that accountants will have to bear to become licensed under these arrangements, which will obviously be passed on to their clients?

Mr Rosser—At various times we have heard a wide variety of costs. It is very difficult to make a judgment about them because they are wide and varied and they seem to move over time.

CHAIRMAN—Treasury hasn't made its own assessment?

Mr Rosser—Of the cost of licensing?

CHAIRMAN—Yes.

Mr Rosser—Not as such, no.

Senator WONG—You have no costs at all associated with licensing?

Mr Rosser—As I say, we have been told what the costs are but of ourselves we are not in a position to ascertain what those costs are.

Senator CONROY—By accountants and other groups?

Mr Rosser—By a number of groups—that is right. Yes, by accountants and people subject to licensing. I note that they do vary widely and they seem to have varied over time from very high before the legislation was enacted. More recently, the estimates seem to be declining.

Senator WONG—Has anyone in government actually done any estimates as to the costs that are imposed by the licensing regime?

Mr Rosser—There was a regulation impact analysis done at the start of the development of the legislation.

Senator WONG—What does that show?

Mr Rosser—It looked at the alternatives available and types of regulatory approach, and the outcome of that was the financial services reform legislation.

Senator WONG—So are you able to give this committee any indication of what it might cost an accountant to become licensed under this regime?

Mr Rosser—I can take it on notice.

Senator WONG—I would be interested in that. You have heard the evidence and my recollection, from just the short time that I have been involved in this committee, is that the indication of cost has varied somewhat, so I would certainly be interested in what you say are varying cost estimates associated with becoming licensed, whether as an authorised representative or otherwise. Are you able to take that on notice?

Mr Rosser—Yes, I will take that on notice.

CHAIRMAN—It seems to me that we are in a catch-22 situation here. The accountancy bodies have indicated they are not going to take up the option of obtaining a licence themselves under which individual accountants or accountancy firms can become proper authority holders. So that means the only alternative for an accountant, other than going to the massive expense of becoming an authorised body, is to become a proper authority holder under the licensee, and the evidence we have heard tonight is that if they do that they are likely to be required to meet certain budgets in terms of sales of financial products, which is really not their purpose in life.

Mr Rosser—I do not have any commentary on that. The legislation does not go to industry structures and the way people are remunerated. I can note there is a problem.

CHAIRMAN—But it is clear that the legislation is creating this problem.

Mr Rosser—The legislation enables a person to take out a licence and enables a person to become an authorised representative of the licensee. There is nothing in the legislation that says the only people who can take out a licence are existing licensees and there is nothing in the legislation that says that a licensee must be a dealer group as has been described. I would note that a number of accountants are already proper authority holders.

CHAIRMAN—It seems to me that the licensing structure is ignoring the practical difficulties.

Mr Rosser—You might need to elaborate on that.

CHAIRMAN—In the sense that accountants who simply, for instance, want to advise on superannuation structures and do not want to get involved in marketing financial products would nevertheless have to become a licensee. The only practical way of doing that, as we have been told, is to be become a proper authority holder. The evidence tonight is that, if they do that, they are going to be required to meet certain sales budgets of financial products which they do not want to do and which is not their purpose in life to do.

Senator CONROY—I guess the committee is still struggling with the concept of financial advice and financial products and the differences between them and what this bill is trying to regulate. It is government policy to regulate financial advice.

Mr Rosser—There are licensees who charge on a fee-for-service basis. There is nothing to prevent a person becoming an authorised representative of a licensee and remitting to the licensee appropriate remittances to cover the costs of their supervision and competency requirements as set out in the legislation. There is nothing in the legislation that requires an authorised representative to sell financial products. In fact, the legislation is directed towards provision of advice.

CHAIRMAN—There may well be nothing in the legislation. What I am saying is that the practical, on-the-ground effect of the legislation is just that.

Mr Rosser—I have to say I do not necessarily agree with that.

CHAIRMAN—Well, that is the evidence we have had tonight.

Senator WONG—Why do you say that, Mr Rosser?

Mr Rosser—As I have said, there is nothing in the legislation that results in that industry structure. That is testimony that has been provided to the committee. As I say, there are a number of licensees that charge on a fee-for-service basis. There is nothing to prevent—

CHAIRMAN—Charge the proper authority holders?

Mr Rosser—No, customers or clients. I can think of one prominent superannuation adviser that actually charges fee for service.

CHAIRMAN—We are talking about the accountants here.

Senator WONG—So how does that interact with what we are suggesting?

CHAIRMAN—It goes to the relevance of what you are saying to dealing with accountants.

Senator WONG—I am sure he is going to explain it to us.

Mr Rosser—The testimony you have heard is that a person would be required to sell financial products. My evidence would be that I do not believe that that would be the case.

CHAIRMAN—It is a matter of assessing the evidence, I guess.

Senator WONG—So there are other forms of remuneration.

Mr Rosser—And there are opportunities for people to take out licences to group together, to take out a licence and structure themselves accordingly.

CHAIRMAN—But we have heard that the cost of that for accountants makes it prohibitive and you have done no analysis of costs; they have.

Senator WONG—He has taken it on notice.

Mr Rosser—As I mentioned, at the moment a number of accountants are proper authority holders. So I would submit that there is a difficulty in saying that the FSR legislation results in a significant change to that situation. If proper authority holders are able to discharge their obligations and perform their services then—

CHAIRMAN—Are those accountants who are proper authority holders doing traditional accountancy work or are they involving themselves in the marketing of financial products?

Mr Rosser—The legislation deals with advising on financial products. Presumably they are aware of that.

CHAIRMAN—I am asking you a question. You have said you are aware that there are a number of accountants who are proper authority holders. The question I am asking you is: are those accountants who are proper authority holders simply doing the traditional accounting work or are they involved in marketing financial products?

Mr Rosser—As I said, they can be doing both.

CHAIRMAN—No, I am asking what they are doing. Do you know?

Mr Rosser—The proper authority holder entitles them to provide advice on securities.

CHAIRMAN—That is not answering my question.

Mr Rosser—With respect, Senator, I think that is what the legislation deals with.

CHAIRMAN—No, I am not asking you about that. You were not talking about the legislation. You said that there are a number of accountants who are proper authority holders. You were talking about a fact, not about the legislation. You were talking about what they are actually doing on the ground. My question to you is: are those accountants who are proper authority holders in the main doing the normal accountancy practice work or are they principally or significantly involved in marketing financial products? I am asking about a statement of fact. You are aware of these accountants, you tell me. I am not talking about the legislation provides. You say you are aware of these accountants. I want to know what they are doing.

Mr Rosser—They will be doing both. If they are an accountant, they will be doing accounting services, and, if they are a proper authority holder, they will be entitled to provide advice on securities. So it would entitle them to do both.

CHAIRMAN—I know it entitles them. I want to know what they are doing.

Mr Rosser—I presume they are doing both, Senator. There is no point in having a proper authority if it is not being used.

CHAIRMAN—So that is different from an accountant who simply wants to take the traditional accounting role, which may include being involved in advising on superannuation structures? It is a different role.

Mr Rosser—It is probably worth while pointing out that the FSR legislation intended to change the way advice on financial services was regulated. That implied that there would be some change in the boundary between the regulated population and the population that fell outside the legislation. So some of the activities that you describe, Senator, as traditional accounting activities were in fact traditionally, if not subject to the incidental advice exemption, available to accountants. They would traditionally have been subject to regulation under the securities legislation. The FSR legislation, in effect, changed that by removing the incidental advice and substituting this regulation, and it was acknowledged from the outset that the boundary line would change.

CHAIRMAN—But not for lawyers.

Mr Rosser—I have no comment on that.

CHAIRMAN—I have no further questions for you.

Senator WONG—On the lawyers: you have been here all evening, I think, Mr Rosser.

Mr Rosser—I have, yes.

Senator WONG—In the discussion with the Law Council, I think Ms Simmons made a point in relation to the dual requirement of 'reasonably necessary' and 'an integral part' of the exemption. I presume there was some reason why both of those aspects were included. I wonder if you could elaborate on that.

Mr Rosser—The essential reason was to ensure that the exemption was available only in relation to the services described by the regulation and to prevent avoidance. The previous legislation, which dealt with incidental advice, did not provide a satisfactory boundary line between the regulated aspects of advice and the non-regulated aspects. The intention of the regulation was to provide a much clearer line.

Senator WONG—Therefore you would not agree with their suggestion of 'or an integral part' of the service? Ms Simmons is nodding, so I think I got that right.

Mr Rosser—Unfortunately, we have only recently been shown the submission from the Law Council. In fact, it has not been sent to Treasury at this stage.

Senator WONG—That is all right. We only got it today.

Mr Rosser—I would need to examine that in some detail.

Senator CONROY—They turned up with 24 hours to go before the Senate vote, and got a thorough exemption, so it is not a surprise. They are very good.

Senator WONG—Not that we are blaming Ms Simmons or Mr Greentree-White for that. So you have not considered those issues?

Mr Rosser—We only received the submission at 4 o'clock this afternoon. We will certainly look at that, in consultation with the Law Council.

CHAIRMAN—There being no further questions, thanks to both of you, Mr Yik and Mr Rosser, for appearing before the committee.

[10.33 p.m.]

BOWLER, Ms Kathryn Laurayne, Director, SMEs, CPA Australia

DAVIS, Mr Peter, Principal, Peter Davis Taxation and Accounting Services

GREENTREE-WHITE, Mr James, Lawyer, Legal and Policy, Law Council of Australia

McDONALD, Mr Peter James, National Director, Taxpayers Australia Inc.

ORCHARD, Mrs Susan Janet, Superannuation Technical Consultant, The Institute of Chartered Accountants in Australia

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

ROSSER, Mr Michael John, Manager, Investor Protection Unit, Corporations and Financial Services Division, Department of the Treasury

SIMMONS, Ms Lisa, Representative, Law Council of Australia

YIK, Mr Andrew Yu Chin, Analyst, Department of the Treasury

CHAIRMAN—We move now to open discussion. Perhaps you would like to sum up and respond to what has come from other witnesses. Please try and be brief.

Ms Bowler—I have two points. The first concerns the hearing we attended last year, in relation to regulation 7.1.29, about being able to get a licence and not give product advice. We have the offer from COUNT, the largest dealer group for accountants, that they are willing to testify that they will not give proper authorities if somebody is not giving product advice, because it is not worth their while to do that. We are certainly not aware of any dealers who offer that facility, because we get asked for it from our members all the time.

The other point was about them applying for a licence in their own right. After 10 March 2004, they will not be able to do so because the only way they will be able to demonstrate they have the experience is either as an authorised representative or by effectively admitting that they have breached the legislation to meet the experience requirements. So they are left with no choice but to become an authorised representative—in most cases that means impinging on their independence among other things; the cost is also a factor—before they will be able to meet the experience requirement to get a licence in their own right.

Mr Davis—I would express to my Treasury colleagues—I have had discussions with them earlier—that the reality is that, as Ms Bowler says, the licence holders insist that you must sell products as part of having the proper authority. You cannot have A without B. It is a plain fact of commercial reality that it just does not happen. It is the practical business of what is going on in the marketplace. I put it that my colleagues have not caught up with what is going on in the marketplace.

Mrs Orchard—Following on from that, those people who are proper authority holders or have become authorised representatives or licensees under the regime have made a commercial business decision to do so with an intention of receiving some sort of remuneration. To make it a requirement of the ordinary commerce of being an accountant adds an additional layer of cost of regulation to what is a function largely driven by compliance and largely driven by the tax act and all the legislative requirements. That is an unfair burden to place, predominantly, on small businesses.

Mr McDonald—I would like to reiterate the issue we brought up in our submission: there needs to be clarity in this whole process. I am not convinced by anything I have heard sitting here tonight that there is in fact clarity; quite the opposite, in fact—it is very fuzzy and confused. Until such time as the delineation between what we see as tax advice, legal advice and financial planning advice is corrected, I think this is going to be a very muddy area. With the whole intention of FSR being to protect the consumer, it seems to me that the consumer is the one in the firing line in this process, and they are the ones that are going to wear incredibly increased costs as a result of the process that is currently in place.

Mr Greentree-White—We do not have anything to add.

Mr Rosser—One comment I would make is that the question that underlies the regulation is the appropriate nature of the regulation to apply to financial advice. That is the primary consideration in developing the legislation and the regulation. The intention of FSR was to improve the standard, quality and uniformity of the regulatory structures that applied to the provision of advice. The regulation is intended to achieve that and to achieve delineation. In our consultations with industry bodies we believe that the delineation was clear, but it was unsatisfactory to them in terms of where the delineation lay.

Mr Reilly—I would like to comment on that, and I might go back without trying to retrace history. One of the challenges we have faced with the whole financial services regime, which goes back to CLERP 6 and even before that back to a green paper, is just how broad financial advice is. In our draft industry guide we have tried to focus on where there is an investment product. Clearly, in terms of superannuation, we have argued at some length that the investment products go into the fund—that is where you start looking at the licensing requirements. I recall correspondence with our previous minister, Minister Hockey, where we asked the question: do you expect to increase the number of accountants that will have to be licensed given that we would argue that accountants under the old regime, where they were giving financial product recommendations, should be licensed? There was always a bit of blurring in terms of incidental advice. The Institute of Chartered Accountants took the view that, if you were recommending financial products under the old act—the current Corporations Act—then it did require licensing. Our understanding certainly was that there would not be a significant increase in the number of accountants that would be licensed as a result of the FSR regime.

Concerning the discussion about superannuation fund structures, if there is a degree of confusion, we would agree with the arguments put forward by the Taxpayers Association. It will create some confusion in the marketplace. We would argue that accountants are able to provide factual advice and an explanation of the difference between various types of superannuation fund structures. That information is in fact on the ASIC web site under the FIDO section. Their web site has information that is similar to the information on the ASFA web site. That is all

accountants are doing. The difficulty then is whether the accountant says, 'Having regard to your circumstances, I believe that this is a better structure for you to go into,' whichever it is, or simply says, 'I've done the analysis; you can work out from the attached spreadsheet which one suits you.' That is the difficulty.

In practice we will argue that the accountant will be able to provide that factual advice. We have recommended and we have picked up from ASIC a clear disclaimer so that the client is quite clear as to what the accountant has provided and what the accountant cannot provide. As for applying for a licence, all of the evidence we have seen is that it will be quite difficult to get a licence so that you just provide effectively a recommendation on factual information. You will be forced down the financial investment product area. That is really where we have seen it to date. We would not have envisaged under this regime that there would have been a significant increase in the number of licences required.

CHAIRMAN—Is there any final summing-up from Treasury?

Mr Rosser—I think I have put on the record the position in terms of defining the manner of developing the regulation and its purpose. It seems to have achieved the purpose of creating a delineation between the regulated and the non-subject-to-FSR regulation activities.

CHAIRMAN—As there are no final questions, thank you all for your attendance and contribution to our deliberations.

Committee adjourned at 10.42 p.m.