The Parliament of the Commonwealth of Australia

REPORT ON THE DRAFT

FINANCIAL SERVICES REFORM BILL

PARLIAMENTARY JOINT STATUTORY COMMITTEE ON

CORPORATIONS AND SECURITIES

AUGUST 2000

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DUTIES OF THE COMMITTEE

Section 243 of the *Australian Securities and Investments Commission Act 1989* sets out the duties of the Committee as follows:

The Parliamentary Committee's duties are:

(a) to inquire into, and report to both Houses on:

(i) activities of the Commission or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of any national scheme law, or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of a national scheme law;

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

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CHAPTER ONE

CONDUCT OF THE INQUIRY

1.1 Following release of the draft Financial Services Reform Bill, the Parliamentary Joint Statutory Committee on Corporations and Securities resolved, on 8 March 2000, to hold an inquiry into the draft Bill.

1.2 On 11 March 2000, the Committee advertised nationally inviting submissions from interested parties. Written submissions in all totalled 67. A list of those who made submissions is included as Appendix 1 to this report.

1.3 Public hearings were held in Canberra on 17 July 2000, in Sydney on 24 July 2000 and in Melbourne on 25 July 2000. A list of witnesses who appeared before the Committee is shown in Appendix 2.

1.4 All submissions and the Hansard of the Committee's hearings on the draft Bill are tabled with this report. Copies of submissions are available on request from the Committee staff on (02 6277 3580). The Hansard of the hearings is available at the Committee site on the Internet (www.aph.gov.au/corps_securities).

1.5 The Committee acknowledges the assistance of those who made submissions or who appeared as witnesses, many of whom did so at short notice. The Committee is grateful for this assistance.

CHAPTER TWO

BACKGROUND TO THE DRAFT BILL

2.1 The draft Financial Services Reform Bill is the culmination of an extensive reform program of the regulatory requirements applying to the financial services industry. It is the sixth stage of the Corporate Law Economic Reform Program announced by the Treasurer in March 1997 as a fundamental review of key areas of regulation which affect business and investment activity.

2.2 Developments in the global and Australian business environment have made imperative the reform and streamlining of Australia's corporate law. Developing a regulatory framework which responds to the demands of contemporary business is a major contribution to achieving Australia's economic goals.

2.3 The reform program has been developed with the benefit of consultation with the business community and the Business Regulation Advisory Group. The objective of the program has been to promote business and market activity leading to important economic outcomes including increased employment by enhancing market efficiency and integrity and investor confidence.

2.4 The reform agenda has been based on the key principles of market freedom, investor protection, information transparency, cost effectiveness, regulatory neutrality and flexibility, and business ethics and compliance.

2.5 The draft Bill is the legislative outcome of a number of recommendations of the Financial System Inquiry (FSI). The FSI proposed that there be a single licensing regime for financial sales, advice and dealings in relation to financial products; consistent and comparable financial product disclosure; and a single authorisation procedure for financial exchanges and clearing and settlement facilities.

2.6 The aim of the regime is to achieve a competitively neutral regulatory framework which provides more uniform regulation, thus reducing compliance and administrative costs and removing unnecessary distinction between products. Further, consumers will enjoy a more consistent system of consumer protection.

2.7 The position paper – F*inancial Markets and Investment Products* – released in December 1977 was followed by a consultation paper, titled F*inancial Products, Service Providers and Markets – An Integrated Framework* in March 1999. An extensive consultation process provided valuable feedback on the reform proposals which resulted in the release in February 2000 of the draft *Financial Services Reform Bill* together with the Commentary on the draft provisions.

2.8 The draft Bill proposes a regulatory framework for the financial services industry that facilitates innovation and promotes business, while at the same time ensuring adequate levels of consumer protection and market integrity.

2.9 The draft Bill covers a wide range of financial products including securities, derivatives, general and life insurance, superannuation, deposit accounts and non-cash payments. The regime will apply to the activities of existing financial intermediaries such as insurance agents and brokers, securities advisers and dealers, and futures brokers, as well as any other person carrying on a financial services business.

2.10 The flexible and adaptable framework proposed will encourage innovation and competition in markets and clearing and settlement facilities.

2.11 The reforms will play a significant role in the Government's push to make Australia a global financial centre.

OUTLINE OF THE BILL

Objects of Chapter 7 of the Corporations Law

2.12 The draft Bill proposes to replace Chapters 7 and 8 of the Corporations Law with a new Chapter 7. The objects of the new Chapter are given as promoting:

- confident and informed decision making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services;
- fairness, honesty and professionalism by those who provide financial services;
- fair, orderly and transparent markets for financial products; and
- the reduction of systemic risk and the provision of fair and effective services by clearing and settlement facilities.

2.13 These objects are to be attained by the draft Bill's key proposals:

- providing comparable regulation of all financial products, including securities, derivatives, superannuation, life and general insurance and bank-deposit products;
- licensing financial markets and providing consistent and comparable regulation for similar financial products;
- licensing all financial advisers and dealers and imposing statutory obligations on these intermediaries which are designed to protect retail investors, and
- ensuring that 'promoters' or issuers of financial products provide comprehensible disclosure documents that assist investors to compare different investment products and to make informed decisions.

2.14 The draft Bill seeks to harmonise the existing diverse regulatory arrangements for financial markets and investment products. Difficulties with the current regulatory framework include the lack of consistent regulation of similar services and products

and overlapping regulatory regimes which impose unnecessary administrative costs on regulators and compliance costs on participants.

2.15 Throughout the draft Bill criteria to be satisfied (for example, to obtain a licence) are broadly stated and flexible to accommodate different market structures, investment products and financial intermediary services.

Key definitions

2.16 Part 7.1 contains the key definitions applicable to proposed new Chapter 7 of the Corporations Law. They will replace some of the existing definitions in the Corporations Law and are drafted so that they are capable of application to the full range of financial products that are to come within the Chapter. For example, the concept of 'able to be traded' will replace the term 'admitted to quotation' in relation to Chapter 7 to reflect the fact that the provisions will apply to all financial products markets and not just those in relation to securities. Similarly, the concepts of 'acquire' and 'dispose' have been defined broadly to capture the wide range of products that are subject to the Chapter.

2.17 The draft Bill draws a distinction between retail clients and wholesale clients. Retail clients benefit from additional protection in the form of:

- the Financial Services Guide;
- the Statement of Advice;
- product disclosure documents; and
- compensation and complaint handling arrangements.

2.18 The definition seeks to accommodate the range of products and services that come within the regime. The draft Bill distinguishes between general insurance products and other kinds of financial products. The test for 'retail client' is different for these two categories of financial products.

Definition of Financial Product

2.19 The draft Bill begins with a broad general definition of financial product which focuses on the key functions performed by financial products. This general definition is then clarified or added to by a list of specific inclusions and a regulation-making power to include further products. The scope of both the general definition and the specific inclusions is then narrowed by a list of specific exclusions, a regulation-making power to exclude products and an ASIC exemption power.

2.20 The general definition focuses on three key functions that financial products provide:

- making a financial investment;
- managing a financial risk; and

- making non-cash payments.

Licensing of financial products markets

2.21 The purpose of Part 7.2 of the draft Bill is to create a single licensing scheme for securities and futures exchanges in a more flexible regulatory framework than the current seven fold licensing arrangements.

2.22 The draft Bill covers the different responsibilities allocated to the Minister, ASIC and market licensees in carrying out their respective functions in monitoring and promoting market integrity and consumer protection.

Licensing of clearing and settlement facilities

2.23 Clearing and settlement facilities are the subject of Part 7.3 of the draft Bill. The purpose of Part 7.3 is to provide a more flexible and comprehensive regime for the regulation of clearing and settlement facilities. Instead of the two routes to authorisation provided in the current Corporations Law, there will be one.

2.24 The draft Bill permits access to the relevant transfer provisions by a wider range of facilities. The proposed provisions will permit (but not require) more than one clearing and settlement facility to handle the clearing and settlement of transactions executed on the one financial product market.

2.25 The draft Bill does not increase the regulatory burden on those clearing and settlement facilities currently regulated under the Corporations Law. Rather than imposing additional obligations, some of the new provisions reflect aspects of the new, more complete framework (for example, suspension of a licence) which are not addressed in the current Law.

Compensation arrangements

2.26 The National Guarantee Fund (NGF) and its administration are addressed in Part 7.4. In addition, requirements are prescribed for compensation arrangements to cover a retail client for specified losses of property entrusted to a participant in a financial products market or clearing and settlement facility, where the NGF does not apply.

Licensing of providers of financial services

2.27 Part 7.5 sets out when an Australian Financial Services License is required, who may apply for a licence and when a financial service is provided. It provides that:

- persons seeking to carry on a financial services business will need to obtain an Australian Financial Services Licence;
- financial services are providing advice, dealing in, or making a market in financial products; operating a managed investment scheme; or providing a custodial or depository service;

- a licence will be required where services are provided to either wholesale or retail clients. Additional obligations will be placed on licensees who offer services to retail clients;
- licences may cover all financial services in relation to all financial products or a subset of services and products;
- transitional licensing arrangements will apply to persons who are currently registered or licensed under banking, insurance, superannuation or Corporations Law regimes;
- licensees may authorise natural persons or corporate representatives to act on their behalf;
- authorised representatives will be able to act for more than one licensee with the written consent of each licensee (cross endorsement).

Disclosure and other conduct requirements for licensees

2.28 Parts 7.6 and 7.7 prescribe the disclosure regime for financial services licensees and regulate the way they deal with their clients' moneys.

2.29 The disclosure regime encompasses a number of elements.

- Disclosure obligations will apply to financial service providers who provide services to retail clients.
- Financial service providers must give their retail clients a Financial Services Guide.
- Where personal advice is provided to a retail client that advice must have a reasonable basis. The provider must investigate the subject matter of the advice having regard to the client's objectives, financial situation and needs, and must base the advice on that investigation.
- The provider must give the client a Statement of Advice including the basis on which the advice was given and information about any conflicts of interest (including commissions, fee, or benefits) that the provider may have in giving the advice.
- The level of analysis undertaken and the issues that should be considered by the provider will vary depending on the complexity of the advice sought.
- Additional information must be included where the advice is to replace an existing financial product. This information must address the potential loss of any benefits and the costs associated with replacing the financial product.
- The client must be warned if the advice is based on information that is incomplete or inaccurate.
- Warnings must be provided to retail clients where general advice is provided.

2.30 Part 7.7 provides that licensees will be required:

- to establish and maintain a separate account in which to hold client (both retail and wholesale) funds;
- where they hold funds or assets on behalf of clients, to provide periodic statements to clients;
- to keep financial records that correctly record and explain the transactions and the financial position of the financial services business carried on by the licensee;
- to prepare profit and loss statements and balance sheets and lodge them together with an auditor's report with ASIC;
- to give priority to clients' orders; and
- to disclose and obtain client consent when they will be acting on their own behalf in a transaction with a non-licensee.

Financial product disclosure

2.31 Financial product disclosure requirements and other requirements relating to the issue and sale of financial products form the subject matter of Part 7.8. This disclosure regime will replace a range of existing disclosure regimes for financial products, some legislative and some self-regulatory. The draft Bill provides for:

- point of sale disclosure through the giving of a Product Disclosure Statement (PDS);
- other disclosure obligations in relation to financial products encompassing:
    - ongoing disclosures; and
    - periodic reporting requirements;
- other obligations for transactions in relation to financial products covering:
    - handling money from applicants for financial products;
    - confirmation of transactions in relation to financial products; and
    - alternative dispute resolution mechanisms for product issuers;
- obligations with respect to advertising in relation to financial product;
- cooling-off periods for certain financial products.

2.32 Part 7.8 will not replace the disclosure requirements for shares and debentures under the Corporations Law. However, some amendments will be necessary to the Corporations Law to take account of the new disclosure regime.

Title to securities and other matters

2.33 Parts 7.9 and 7.10 conclude the draft Bill, dealing with matters relating to title to, and transfer of, certain securities and other financial products. Qualified privilege, the role of codes of conduct and the Minister's power to delegate are also covered.

CHAPTER THREE

GENERAL SUPPORT FOR DRAFT BILL IN SUBMISSIONS

3.1 The vast majority of the 67 submissions received by the Committee expressed general support for the principles and objectives of the draft Bill. Numbers of submissions referred favourably to the draft Bill implementing aspects of the Financial System Inquiry recommendations. In this context several submissions referred to the draft Bill as a milestone or a watershed for Australian financial services. In particular, submissions supported the policy objectives of the draft Bill, especially its uniform requirements within a single comprehensive framework. In this context several submissions pointed to the advantages of a level playing field. A number of submissions suggested that the draft Bill would facilitate the use of information technology in financial services. A considerable number of submissions expressed satisfaction that the draft Bill had taken into account suggestions and concerns expressed earlier in the consultative process. The following paragraphs set out comments made in submissions about the general scheme of the draft Bill. The comments are intended to illustrate the range of support for the draft Bill across the whole of the financial services sector.

3.2 The Australian Securities and Investments Commission (ASIC) submitted that, apart from the issue of the transitional arrangements to the new licensing regime, it strongly supported the proposed single statutory regime for intermediary licensing, which would protect consumers and facilitate efficient business conduct by imposing consistent regulatory standards across functionally equivalent financial services.

3.3 The AMP Limited submitted that it supported the aim of uniform regulation of financial products. The draft Bill was a significant milestone in the process of financial services industry reform. It was a legislative package capable of establishing the foundations for a dynamic, evolutionary and expanding financial services sector in Australia. AMP appreciated the extent of consultation that was undertaken and offered its congratulations on this process and the extent to which the legislative framework had been adjusted to meet the commercial realities of the modern financial services industry; it was sensible, focussed dialogue on financial sector reform. AXA Australia also broadly supported the reforms proposed in the draft Bill. AXA advised that these were a welcome step in producing a globally competitive and dynamic financial sector. The reforms should provide a strong foundation for national economic and business growth and would help to position Australia as a leader in financial services within the Asia-Pacific region.

3.4 NRMA Limited advised that it supported the general thrust of the draft Bill, which was an important milestone for the Australian financial services sector. The draft Bill would deliver significant benefits both to the sector and to consumers. These benefits include potentially lower costs from uniformity of regulation and greater

consumer confidence in the industry and its products. NRMA was pleased to note that the draft Bill had addressed several areas of concern which it had raised earlier.

3.5 The Insurance Council of Australia (ICA) advised that congratulations were due for the way in which this wide and complex issue had been handled. The ICA was greatly encouraged that a number of its earlier recommendations had been included in the draft Bill. Lloyds Australia Ltd welcomed the draft Bill and supported its intention of a more efficient and flexible regime for financial markets and products through an integrated regulatory framework. The National Insurance Brokers' Association (NIBA) supported the proposed structure of the draft Bill, which should benefit business and consumers. NIBA was particularly pleased that many of the earlier comments and concerns had been addressed. The Australian Aviation Underwriting Pool Pty Ltd advised that it supported the main elements of the draft Bill.

3.6 Telstra advised that it understood the impetus for reform of the financial services sector and commended such radical action. The reforms should have a positive impact on consumer confidence in using online financial services. APIR Systems Pty Ltd submitted that the draft Bill was a major contribution to the changing ecology of the financial services environment which will provide an impetus to industry in the context of the new market; the draft Bill replaces the present process driven regulatory regime with one that is outcomes oriented and solidly based in commercial rather than regulatory needs. The Australian Society of Certified Practising Accountants (CPA) and the Institute of Chartered Accountants in Australia (ICAA) submitted that they supported the underlying policy objectives of the framework of the draft Bill.

3.7 The Australian Financial Markets Association (AFMA) and the Securities and Derivatives Industry Association (SDIA) commended the commitment to establish a comprehensive regulatory framework that facilitates innovation and promotes business, while at the same time ensuring adequate levels of consumer protection and market integrity; the draft Bill is a watershed, significantly progressing the existing regulatory position. Australian Stockbroking Limited submitted that the draft Bill was an ambitious attempt to rationalise financial services law and, among other things, to recognise the significance of electronic provision of financial services.

3.8 The Financial Planning Association (FPA) submitted that it fully supported the intention of the draft Bill to introduce a comprehensive regulatory framework and a single licensing system based around universal principles that can be adopted to meet new developments. The Investment and Financial Services Association Ltd (IFSA) submitted that the draft Bill effectively implements the broad thrust of the Financial System Inquiry reforms in the licensing and distribution of financial services. The result should be to rationalise and modernise the regulatory and consumer protection regimes for the financial services sector. IFSA strongly supported the flexible and rigorous single licensing regime and the conceptual approach of the financial product disclosure provisions. The Association of Superannuation Funds of Australia Limited (ASFA) supported the general direction of CLERP6. The Securities Institute of Australia (SIA) advised that it supported the

general concept of an integrated regulatory framework for Australia's financial markets, clearing and settlement facilities and financial service providers, as recommended by the Financial System Inquiry. The Association of Financial Advisers (AFA) supported the general thrust of the draft Bill, advising that the change to one regulator and one set of regulatory rules was especially important. The National Council of Financial Adviser Associations (NCFAA) also supported the thrust of the draft Bill and was pleased to note that many of the issues which it previously raised had been now adequately covered.

3.9 BT Funds Management Limited offered congratulations on the reform and rationalisation of the financial services industry and in particular on the initiatives for a single licensing and disclosure regime. Morgan Stanley Dean Witter (MSDW) advised that it supported the thrust of the Financial System Inquiry; the draft Bill would effectively implement many of the recommendations of that Inquiry. In particular, MSDW supported the initiatives in the draft Bill which:

- promote the consistency of regulation of similar financial products;
- increase the flexibility of the regulatory structure to ensure that it is better able to cater for change, especially technological change, within the financial system; and
- remove unnecessary and burdensome regulatory requirements which add little to consumer protection and impose significant compliance costs on industry participants.

3.10 The Deutsche Bank Group advised that it supported the reform program and the positive changes which are being made to the financial sector and markets. The Credit Union Services Corporation (Australia) Limited (CUSCAL) supported the policy objectives of the draft Bill, including a single licensing framework, better consumer protection and a better informed financial services marketplace.

3.11 The Australian Conservation Foundation (ACF) welcomed efforts to put in place a regulatory framework for the Australian financial services industry, in particular the uniform disclosure obligations for financial products provided to retail clients. The Finance Sector Union of Australia (FSU) submitted that it generally supported the obligations which the draft Bill placed upon licensees to ensure that competence, skills and experience to provide financial services are maintained and that representatives are adequately trained and competent.

Policy and drafting clarification of aspects of the draft Bill

3.12 As noted above, almost all of the submissions received by the Committee supported the general thrust of the draft Bill. The submissions, however, almost without exception, included detailed suggestions for clarification of provisions of the draft Bill in relation to its intended effect and to drafting. In this context the Committee noted the extensive consultation process organised by the Treasury in the development of the draft Bill. The process started in December 1997 with the release

of an initial position paper for public comment. In March 1999 a consultation paper sought reaction to a more detailed outline of the proposals. The draft Bill and an associated commentary was issued in February 2000 for comment by interested parties. In April 2000 Treasury organised three roundtables with thirty stakeholder representatives. Treasury has also had a considerable number of direct meetings with interested parties since the release of the draft Bill.

3.13 Treasury officials advised the committee that generally speaking reaction to the draft Bill had been positive, with most comments relating to technical finetuning and drafting. In relation to these, however, the officials advised that definitional comments could have a substantial effect on whether a particular activity came within the ambit of the draft Bill.

3.14 The Treasury officials also advised that it would not be appropriate to announce any changes to the draft Bill or of policy intention resulting from their consultations, in advance of any statement by the Minister. The officials stated, however, that in general terms the final Bill, which it was intended to introduce into Parliament early in the spring sittings, would not be substantially different from the draft Bill. This was because the comments received by Treasury were less to do with fundamental policy issues and more to do with the drafting of individual provisions, whether particular activities are included within these provisions and the practical implications of this. The Government's response to the concerns and comments received during the public consultation process would be the final Bill as introduced into Parliament. This response would be determined by considering all comments in the light of whether the present drafting is appropriate to achieve what was intended. If not, then the drafting of the final Bill would be changed.

3.15 The 67 submissions received by the Committee were well over 1,000 pages. As mentioned earlier, most of these were extremely detailed, consisting mainly of comments on the drafting of specific provisions and the possible effect of these on the individual stakeholder. It would not be possible for the Committee to address all of these technical drafting concerns, but it accepts that the Treasury has done so and that the final Bill will clarify any provisions to ensure that the practical effect of the legislation will mirror its policy intentions. The Committee has decided, therefore, to highlight a number of the more important broad issues raised by the draft Bill where it appears that changes could be made to its intent and drafting. The six issues chosen are not intended to be an exhaustive survey of all unintended consequences or possible anomalies in the draft Bill. Rather they were chosen to illustrate the different interests of stakeholders across the whole spectrum of the financial services sector and the need to ensure that drafting should precisely reflect policy intent. The Committee has also decided to report as early as possible, so that the Government's response to its recommendations can be included in the final Bill.

CHAPTER FOUR

ISSUES ARISING FROM THE DRAFT BILL

Introduction

4.1 The Committee isolated six main issues arising from the submissions and hearings in relation to the draft Bill. As noted in the previous Chapter, these issues are not a definitive survey of all matters raised during the inquiry. Instead they are intended to highlight the more significant aspects of the practical implementation of the draft Bill and some broader questions relating to financial regulation. Again, as noted previously, the Committee decided to report as early as possible, to enable the Government to include its response to the report in the final Bill as presented to Parliament.

Adverse effects of the draft Bill on the delivery of financial services in rural and regional areas

4.2 The Committee identified adverse effects on the delivery of financial services in rural and regional areas as the most important issue arising from the draft Bill. The Committee received overwhelming evidence from regional banks, building societies and credit unions as well as the major banks that, as presently drafted, the draft Bill places an onerous and inappropriate regulatory burden on the industry, which if implemented would seriously affect the range of services currently being provided in regional areas. The Committee also accepts the evidence put before it that the inclusion of basic banking products in the definition of financial product and the flow on effects this has on the industry, in terms of both training for counter staff and the cost of complying with the disclosure regime that accompanies advice concerning financial products, is the element of the draft Bill which jeopardises the financial industry's ability to continue to maintain its present level of service in regional areas. The Committee believes that any reduction in service to regional areas would be a most unfortunate and unacceptable development.

4.3 The Australian Bankers' Association (ABA) told the Committee that it was concerned that the draft Bill did not take sufficient account of functional differences between certain financial products. The most important of these was the difference between traditional banking products issued by authorised deposit taking institutions and other investment or market linked financial products. These banking products are issued by prudentially regulated bodies, are capital assured and are not speculative or related to a market. They are generally repayable on demand and are well understood in the community. The draft Bill, however, equated these products with investment products where there was a potential risk of loss of both income and capital. There are two key areas where this is inappropriate: the giving of advice by counter staff and the agency distribution of these simple banking products. For instance, the draft Bill imposes onerous conditions in relation to banks and their agents, who are often rural

businesses such as newsagencies or pharmacies. These conditions would apply not only to the proprietors of those agencies, but also to every employee who provided financial products to retail clients.

4.4 The ABA advised that there are particular difficulties with rural and regional services in relation to the divide in the draft Bill between the provision of factual information and the provision of financial advice. Banks and agencies may have to commit to rigorous staff training programs even where the risk profile of a product is negligible. Also, there are very few consumer complaints about basic transaction banking products, because they are repayable on demand. It would be difficult to see disputes arising in those situations.

4.5 While giving evidence to the Committee the ABA noted that the Financial System Inquiry report—the Wallis report—at page 263 recognised the differing functional characteristics of financial products when proposing regulatory oversight of disclosure requirements. The ABA, quoting directly from the Wallis report, outlined for the Committee the inquiry's conclusion that the different level of risk profile in simple banking products compared with those of an investment nature needs to be recognised. The ABA further noted that whilst this recognition of difference had been reflected to a degree in the draft Bill in respect of product disclosure, the approach did not flow through the draft Bill's provisions relating to other requirements, particularly advice and third party relationships.

4.6 The Commonwealth Bank told the Committee that the inclusion of deposits within the draft Bill was a major concern. The present level of prudential regulation had allowed banks to offer simple, flexible, low cost deposit taking facilities. These products should be removed from the ambit of the draft Bill. Under the proposed provisions even these simple products explained by counter staff would be subject to the full advice process. At present, the Commonwealth Bank has about 17,500 staff in its branch network, of whom 1,200 are authorised to give advice. Under the draft Bill, however, some 13,000 would need to be trained to the level of giving advice.

4.7 The Commonwealth Bank advised that these provisions of the draft Bill would make it almost impossible to continue offering the same level of banking services for rural and regional customers. About 40% of the 110,000 Commonwealth Bank access points were in these areas, many of which are provided through agencies. Many of these continue to operate viably only because they provide banking services.

4.8 The Bendigo Bank Group told the Committee that there was a major difficulty in distinguishing between product information on the one hand and financial product advice on the other. There were particular concerns with the effect of this on local agencies such as pharmacies, newsagents and stock and station agents, in rural and regional areas.

4.9 The ANZ Bank advised that there was a lack of clarity in the definitions of general and personal advice, flowing from the failure of the draft Bill to take account of the differences between low risk basic banking products and higher risk investment

products. The onerous obligations under the draft Bill would threaten the expansion of services to small communities in country locations.

4.10 Westpac Bank advised that the inclusion of basic banking products (such as those used to meet everyday transactions and not used primarily to obtain significant return on funds) and the flow on effects in terms of training and disclosure requirements that follow this inclusion, would adversely affect rural and regional customers. They advised that the viability of in-stores would be threatened and the willingness of small business people in country towns to act as agents would, in all probability, decrease. Westpac noted this could constrain access for basic banking products for rural communities.

4.11 Westpac also advised the Committee that the inclusion of basic banking products in the draft Bill could not be in response to customer concerns as complaints data and market research supported the proposition that customers are currently being provided the most appropriate deposit account for their needs in the vast majority of instances. Westpac, like the ABA, also shared the view that the inclusion of basic banking products within the ambit of the draft Bill did not align with the recommendations of the Wallis Inquiry which recognised the need for consumer protection measures to differentiate between the different risk profiles of different products.

4.12 The Australian Association of Permanent Building Societies (AAPBS) advised that about 750 of their 1,120 outlets were agencies which, like their branches, offer simple deposit and transaction accounts. In this respect the definition of financial product advice in the draft Bill was too broad and indiscriminate, which would impact adversely upon the distribution of their services through agencies.

4.13 The AAPBS advised that the draft Bill had obvious problems for building society agencies, which are usually businesses in a country town. If counter staff had to be trained to give full personal advice then the costs were such that building societies may decide that it is not worthwhile to continue to operate agencies. The AAPBS quoted Mr Mark Scanlon from the Bass and Equitable Building Society, the only building society in Tasmania, as saying that under the provisions of the draft Bill there was no point in continuing agencies. Mr Scanlon later provided the Committee with a summary of agency business for the Bass and Equitable Building Society.

Location	Business Type	No. of Accounts	No. of Transactions in June 2000
Devonport	Jewellery store	143	751
East Devonport	Newsagency	810	1611
Shorewell	Newsagency	31	613
St Helen's	Photography processor	669	593
Latrobe	Home Hardware/ Festival Supermarket	231	683
Penguin	Travel Agency	377	522
Smithton	Pharmacy	916	632
Sheffield	Pharmacy	324	416
Deloraine	Pharmacy	385	483
Somerset	Newsagency	56	372
Stanley	General Store	260	298
Riverside	Pharmacy	222	587
Kingsmeadows	Pharmacy	75	838
Shearwater	Newsagency	356	805
TOTAL		**4855**	**9204**

4.14 The Credit Union Services Corporation (Australia) Ltd (CUSCAL) told the Committee that the draft Bill imposed onerous disclosure and conduct requirements, which were appropriate only for risky investment products, on simple core banking products. Credit union products were simple, safe and widely understood. The result of the new requirements would be to increase costs for staff training and business systems. In particular, the draft Bill would have a negative effect on rural services through agents and the rural transaction centres. The increased burden may result in these services becoming uneconomic.

The information economy and e-commerce

4.15 The Telstra evidence included much comment on the information economy, convergence and the on-line delivery of financial services. The Committee regards these as of central importance in the reform of financial services. The Telstra evidence raised many questions in relation to these matters which, like Australia's international competitive position, will be a core element in future economic performance.

4.16 Telstra representatives advised the Committee that it supported the draft Bill, but had some concerns about the operational implementation of the reforms and the compliance issues which flow from implementation. These concerns are that certain transactions may be inadvertently brought within the legislation. The main area of concern relates to trade credit. Telstra is the largest credit provider in Australia in respect of non-interest charging credit and provided a range of choices for consumers

as to how they pay their phone bill. Product choice and selection includes paying by means of the emerging opportunities through the Internet and on-line or through other bill payment mechanisms. Telstra understood that the draft Bill was not intended to include trade credit but that this was not expressly clear in the present drafting.

4.17 Telstra also advised that it was very concerned about the potential for overlap between the draft Bill, which will be black letter law, and a new EFT code of conduct being developed by the industry association, which is a self-regulatory model. There is also a plethora of codes of practice being developed under the Australian Communications Industry Forum for customer relationships in credit management. These codes include billing, complaint handling, compensation, privacy and similar issues. Telstra advised that it was worried about dual compliance obligations at the operational level. In particular, there was the issue of compliance of "front of house" staff who give advice to consumers which would be either personal advice, general advice or investment advice, which would be caught by the draft Bill. It is important that any overlap between the draft Bill and the EFT code be resolved before either commences and that they operate in a logical sequence.

4.18 The costs and timeframe of compliance were also of concern to Telstra. The putative commencement date of 1 January 2001 could impose quite significant costs, particularly with the systemic issues resulting from compliance check lists and staff training. There could be a serious risk of operational dysfunction and non-compliance. If staff have to be trained to give personal advice as a result of the final legislation and regulations, the systems and process changes are potentially horrific.

4.19 Telstra advised that another important point was the potential of convergence and on-line delivery of financial services, which would be quite different from the previous off-line delivery. There are issues of how the requirements apply to a consumer who is clicking through options on-line. Telstra is at the forefront of convergence in the e-commerce environment and intends to be more involved in the financial services sector, particularly in on-line applications. Telstra advised that new delivery mechanisms for financial services, such as the so-called smart card market, are not yet mature and that there is some concern at the degree of regulation necessary at this time. Black letter law could discourage innovation in the technology area, which would be disadvantageous to e-commerce. The e-commerce framework should have high-level regulation but not detailed prescription, particularly in the area of business to consumer. There is concern that if the draft Bill and the self-regulatory codes do not dove-tail, then there may be operational dislocation and failure to achieve the best out of the so-called new economy in cyber space.

4.20 The Telstra representatives gave further details of instances of its front of house staff providing advice to consumers with inadvertent consequences. Such advice included payment options for a telecommunications service, a mobile phone plan, or a smart card scheme. Telstra advised that some definitions in the draft Bill were so vague and general that these day to day transactions could be seen as providing a financial service and giving financial advice, for instance in the case of a consumer in difficulties who is unable to pay their bill.

4.21 Telstra further advised the Committee that a concern arose because front of house staff were expected to cross sell other Telstra products. For instance, a telephony product associated with a mobile phone plan may have a payment choice with a commission from a partner that delivers on-line insurance or banking services. This is a grey area, especially because Telstra's main portal provides basically all consumer on-line products, including e-commerce products as well as the traditional telephony products.

Australia as an international financial centre

4.22 The Committee decided to highlight the comments and concerns of the Australian Stock Exchange Limited (ASX) because they relate closely to the crucial issues of Australia's international competitive position and to its role as an international financial centre. Both the Financial System Inquiry and the discussion papers for CLERP6 indicated that any reform should address these issues. The ASX evidence also raised interesting conceptual issues about the nature and purpose of regulation of the financial sector.

4.23 The ASX representatives placed before the Committee a number of issues which they advised are vital to the positioning of Australia as a global financial services centre. By way of preliminary comment the ASX advised that the Australian stockmarket capitalisation was now about $655 billion, four times its size of a decade ago. Trading volumes have grown just as rapidly over this period, which in turn has led to growth in liquidity, one of the most competitive features of a market. The number of retail investors has also increased, although shares are still a relatively new form of investment for many retail clients. The Australian stockmarket, however, although the twelfth largest national market in the world by market capitalisation, is only about 1.12% of the world total, compared with the 50% for the United States and 33% for Europe.

4.24 In this environment, the ASX advised, the Australian market needs to be able to respond quickly to change, domestic and international, in order to continue to grow and to remain relevant. The regulatory framework is a key element in Australia's ability to compete effectively. The ASX is therefore concerned that the draft Bill increases the regulation of the financial services sector and that this may affect adversely the level of domestic innovation in the marketplace. Australia's relatively small size in the global marketplace means that we can not afford inefficiencies in the regulatory framework of financial market products and services. The level of financial markets regulation should be that which best promotes market confidence, best facilitates the choice of Australia as a centre for financial markets operations and best equips our financial market participants to compete internationally.

4.25 The ASX representatives told the Committee that the draft Bill is far stronger on its regulatory and retail investor protection elements than on wealth creation, encouraging entrepreneurship and innovative business development. There are a number of areas where regulation has been quite significantly increased with no particularly cogent reasons for the increase. The different levels of regulation add

levels of cost and levels of inefficiency and could put Australia at a disadvantage internationally.

4.26 In this context the ASX noted that the draft Bill regulates Australian market and clearing settlement facilities more heavily than foreign-based markets which may operate in Australia. The ASX suggested that this may be partly a drafting problem, but that if it is not and is in fact a policy issue, then there is a risk that the draft Bill will hamper on-shore facilities and not properly protect Australians with access to off-shore facilities. Australian incorporated entities will be regulated under the draft Bill regardless of whether they operate in Australia, which will be an incentive for off-shore incorporation and operations.

4.27 The ASX representatives also raised the question of cost effectiveness, which the draft Bill was intended to enhance. The benefits of the draft Bill were intended to outweigh its costs. The ASX advised, however, that the draft Bill in fact increases the level of regulation. The ASX concluded that some of this additional regulation may be warranted, but there does not appear to have been a reduction in the other areas where regulation could have been reduced. For instance, the ASX suggested that the draft Bill framework for compensation for retail investors was unnecessarily complex, which would confuse investors about avenues of redress and raise issues of market costs and efficiencies. The ASX submitted that it was possible to streamline these procedures.

4.28 The ASX further advised that there were areas where it was unclear how much regulation there would be, because the level was being left to ASIC or the regulations. In this regard the ASX noted that the model for stock market regulation in Australia has been co-regulation, which is a combination of statutory and self-regulation. This model achieves a productive collaboration between the government regulator and the self-regulator, in this case the ASX. The Minister has assured the ASX that the draft Bill would not change the relationship between ASIC and the ASX or increase the regulation of markets. It is fundamental to the co-regulatory framework that the Minister remains directly involved, because of the economic and policy focus which the Minister and the Department can bring to bear on regulatory issues. For instance, under the draft Bill the Minister could take action which would bring aspects of the operation of the national guarantee fund into line with international practice and enhance Australia's international competitive position. Conversely, the Minister had wide powers of delegation to the statutory regulator which would need to be exercised appropriately.

4.29 The ASX representatives also raised the issue of the present 5% limit on individual shareholdings in ASX as a demutualised entity. The ASX submitted that the limit, if retained, should be increased to 15%, in line with the banking sector, with the possibility of a larger proportion, subject to a fit and proper person test. In the near term the funds of millions of Australians would be invested across a number of markets operated by different commercial companies with a range of ownership structures. There will not be an even-handed competitive environment if structural restrictions are placed on one type of market operator, or just one operator, instead of

being evenly applied. Restrictions on ownership should be justified in relation to regulatory outcomes and the efficient operation of the economy.

4.30 Finally, the ASX described the transitional arrangements under the draft Bill as being of critical importance. Many details were still not known. The ASX advised that there must be consultation with industry on these details and sufficient time for industry to prepare; this was necessary for a smooth and cost-effective transition period. The role of ASIC during this period would be critical and the ASX would support wide powers for ASIC to modify the application of the new provisions and to exempt or extend the time for compliance.

The impact on small business

4.31 The Committee considers that it is important that the draft Bill does not impact adversely upon small business. In this context the Committee noted the evidence of the Life Agents Action Group (LAAG) and the Association of Financial Advisers (AFA), both of whom expressly represented small business. Their evidence was particularly valuable, not only for the views expressed, but also as a contrast to submissions received from larger organisations.

4.32 The Life Agents Action Group (LAAG) raised the issue of commission disclosure on risk business; that is, insurance products which do not have any investment or savings content. The LAAG submitted that commission disclosure on risk business serves no benefit, with no evidence of genuine consumer concern. In any event, commission content of a risk sale has no impact on claim payment or policy benefits. Also, agent preference for a particular company or product is related not to commission, but rather to service and relationships. Agents who are mainly commission driven will go broke. The draft Bill is particularly unjust in that it requires commissioned agents to disclose earnings, while salaried officers are exempt. Moreover, salaried officers are usually placed on quotas and receive bonuses. Consumers at present have a right under other Commonwealth legislation to request information about commissions; this is acceptable but few ever do ask.

4.33 The Association of Financial Advisers (AFA) raised similar concerns. The AFA agreed with commission disclosure on investment and superannuation products where the results are affected by the amount of commission paid. However, for pure risk products the commission does not affect the price of the product or its outcome; disclosure will not help a consumer to make an informed decision on insurance cover. Disclosure, if necessary, should be total distribution costs and not just commission. Big companies employ salaried officers who do not have to disclose remuneration, whereas small self-employed businesses must do so. In many cases it is even the same product which is being sold. This is not a level playing field. Also, some insurance companies have a high expense base but pay virtually no commission; this is because their marketing costs are very high. The AFA submitted that commissions are only one cost, which did not necessarily reflect the quality of the product.

Co-regulation and the position of professional bodies

4.34 As with the position of rural and regional deposit taking agencies, the Committee believes that the draft Bill should not affect anyone whose involvement in financial services is incidental to their main activity. In addition, the draft Bill should apply in the clearest possible fashion. The Committee believes that both the accounting and legal professions provided significant input in this area and that the co-regulation model has potential to be expanded into other areas of the financial services sector.

4.35 The Law Institute of Victoria (LIV) submitted that the draft Bill had significant implications for the way in which legal practices are conducted, with the potential to increase the cost of legal services for consumers due to the dual overlapping regulatory requirements which would apply to the legal profession.

4.36 The LIV submitted that the draft Bill could include within its coverage the majority of lawyers, who as part of and incidental to their day to day legal practice, either provide financial product advice, deal in a financial product, or provide a custodial or depository service. Providing any of these services (apart from as an authorised representative of a licensee) will require a lawyer to hold an Australian Financial Services Licence and comply with the disclosure and other provisions of the draft Bill.

4.37 The LIV suggested that the definition in the draft Bill of financial product advice is wide and could cover a number of unintended situations. For instance, it could include a lawyer who advises on the scope of cover of a general insurance policy; or who advises a client not to purchase a business by way of shares, because the lawyer has discovered contingent liabilities in relation to them; or who advises about legal aspects of superannuation or other investment products being considered by the client. In these cases, a general insurance policy, shares and superannuation are all financial products.

4.38 The LIV submitted that where such advice to a client is part of, or incidental to, a legal practice, such advice should be either expressly excluded from the draft Bill, or prescribed by the regulations to be outside the definition. This would be consistent with the existing exemption applying to lawyers where advice is given in those circumstances, under the Corporations Law and the relevant ASIC Policy Statement. This approach, the LIV submitted, would continue the present position and maintain the policy underlying the present exemption. If, however, a lawyer provides financial advice as a financial planner or adviser, then he or she should be licensed under the provisions of the draft Bill. In these cases retail clients should be entitled to all of the protection of the proposed legislation. It is essential to maintain the present exemption of incidental activities, even though the draft Bill provides for ASIC to make declarations in relation to professional bodies. Nevertheless, the draft Bill should retain the declaration procedure, which should be available to members of professional bodies who hold themselves out as financial advisers as well as legal

practitioners. Such a declaration is, however, subject to the relevant professional body being willing and able to convince ASIC that it has met the required criteria.

4.39 The LIV also submitted that perceived anomalies in relation to product disclosure statements, dealing in financial products and providing a custodial or depository service, should be addressed.

4.40 Finally, the LIV expressed concern about the proposed commencement date of 1 January 2001, which would not give its members sufficient time to implement systems and procedures to ensure proper compliance, apply to ASIC for licenses and declarations or comply with training and other requirements. In addition, much of the substance of the reform will be in regulations and ASIC policy decisions, which have not yet been made public. The LIV considers that 1 July 2001 would be a more realistic commencement for the draft Bill. There should also be a transition period of at least 6 months so that professional bodies can be confident that relevant obligations in relation to licensing, conduct and disclosure would not apply until all applications had been processed.

4.41 The Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia (the Accounting Bodies) submitted that one issue which required clarification was who the draft Bill required to be licensed. The Accounting Bodies advised that if specific financial product advice was being provided, then licensing is appropriate. However, under the present provisions of the draft Bill there is a risk that all 100,000 of their members must be licensed. This was because professionally qualified accountants give financial advice as a routine activity. The Accounting Bodies suggested that licensing in these circumstances was not the intention of the draft Bill and that this should be made explicit. The Accounting Bodies also supported the provision in the draft Bill under which ASIC could declare professional bodies, which met stringent criteria, to participate in the licensing regime. This provision is in accordance with an express recommendation of the Financial System Inquiry. In relation to declared professional bodies, the draft Bill continues a long history of co-regulation. Nevertheless, the standards which ASIC would apply must be developed in full consultation with the Accounting Bodies if they are to be realistic. These standards should be as precise as possible.

4.42 The Accounting Bodies submitted that the present exemption for incidental financial advice is uncertain and confusing. There is a real risk that the Corporations Law is being breached, with a consequent result that professional indemnity insurance is invalid. This would have a severe effect upon clients. In the practical world of the practising accountant the present legislation simply does not work. At this stage, it is not clear that the draft Bill will resolve these issues.

Proper recognition of corporate structures and the definition of retail/wholesale client.

4.43 A number of submissions suggested that the draft Bill included anomalies as a result of a failure to recognise the conglomerate as a typical corporate structure in the

financial sector. This deficiency is in spite of the Financial System Inquiry expressly commenting on the existence and operation of financial conglomerates. This omission from the draft Bill will have adverse consequences for conglomerates in relation to costs, disruption and capital gains tax.

4.44 The Commonwealth Bank submitted that the draft Bill failed to take into account the structure of financial service conglomerates; it would be necessary to modify certain licensing and disclosure provisions to provide suitable exemptions. At present, many areas of the draft Bill do not recognise current conglomerate structures, which will force those conglomerates either to undertake fundamental structural change or to adopt administratively complex procedures. Either of these would be costly and disruptive. Also, any structural change may have adverse capital gains tax implications. In most financial service conglomerates, staff are employed by a single corporate entity within the group, while other related entities within the group hold licences to provide financial products and services. These licensed entities usually do not employ staff of their own, but use the employees of the service or holding company. The Commonwealth Bank suggested a number of amendments to the draft Bill to ensure that licensing and disclosure provisions apply fairly to financial services conglomerates. On a related issue, the Commonwealth Bank advised that certain corporate entities such as licensed dealers, superannuation funds and responsible entities, which are logically wholesale clients, may not meet the relevant conditions of the draft Bill and would therefore be treated as retail clients. Here again the Commonwealth Bank suggested amendments to overcome these difficulties.

4.45 The Australian Bankers' Association (ABA) submitted that the draft Bill seemed to ignore the nature of the financial conglomerate, despite the Financial System Inquiry expressly noting that the Australian financial system already predominantly comprises financial conglomerates. The FSI also noted that conglomeration is assisted further in some cases by innovation in product design so that products which have been traditionally the preserve of one type of institution may be offered by entities of another type. The ABA suggested amendments to the draft Bill similar to those put forward by the Commonwealth Bank. A number of other submissions made similar points about the conglomerate structure and about the distinction between wholesale and retail clients.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

Final Bill should be passed

5.1 The Committee concludes that there is general support for the broad thrust of the draft Bill. Almost all submissions, however, included detailed comments on individual provisions in relation to their application or technical drafting. The Treasury has assured the Committee that all of these concerns will be taken into account in the final Bill, which would include drafting changes to ensure that the Bill, as it comes before Parliament, precisely expresses its policy intent. Therefore, subject to the Committee's further recommendations set out below, the Committee **recommends** that the draft Bill proceed as the basis for the final Bill to be introduced into Parliament.

Adverse effects of the draft Bill on the delivery of financial services in rural and regional areas

5.2 The Committee accepts the overwhelming and unanimous evidence presented by the regional banks, building societies, credit unions and the major banks that, as presently drafted, the inclusion of basic banking products within the ambit of the draft Bill imposes requirements on approved deposit taking institutions which would have a devastating effect on the level of services offered by agencies of these institutions in regional areas. In many cases these institutions would be forced to terminate their rural agencies, which would have an unacceptable effect on the local community. Indeed, in some cases the withdrawal of the agency would mean that the business operating the agency would not be viable.

5.3 Moreover, the Committee also recognises that the disclosure and training requirements associated with more complex financial products - which are by nature investment products – are inappropriate for basic banking products where there have been few concerns expressed about inadequate consumer protection. Furthermore, the Committee recognises that such requirements on basic banking products are not aligned with the express intent of the Wallis Inquiry on this matter.

5.4 Accordingly, in order to solve this problem, the Committee **recommends** that the draft Bill be amended as follows :

AMENDMENT TO DEFINITION OF FINANCIAL PRODUCT

A facility or arrangement provided by an authorised deposit taking institution within the meaning of the Banking Act 1959 (Cth) shall not be taken to be a financial product where:

(1) (a) the facility or arrangement is a deposit of funds received in the course of banking business; and

(b) the amount of funds held on deposit cannot, under the terms and conditions governing the facility or arrangement, diminish other than as a consequence of one or more of:

(i) a withdrawal or transfer on the instructions or by the authority of the depositor;

(ii) a debit authorised by the depositor for the payment of fees or charges; or

(iii) a payment of government charges, or duties, on receipts or withdrawals; or

(iv) the exercise of any right to combine accounts or any right pursuant to a contract, lien or charge arising by operation of any Act, law or custom; or

(v) compliance with a court order or statutory obligation; and

(c) the amount of any return to the depositor, or the interest rate for calculating any return to the depositor, is fixed under the terms and conditions governing the facility or arrangement;

OR

(2) under the terms and conditions governing the facility or arrangement, the funds held on deposit may be withdrawn upon the demand, or under the authority, of the depositor;

OR

(3) the facility or arrangement provides a means of payment by which funds are drawn or transferred from, or paid to, a facility or arrangement described in (1) or (2).

The information economy and e-commerce

5.5 The Committee concluded that the e-commerce and other issues, particularly the issue of advice on non-financial products, raised by Telstra have merit and **recommends** that they should be addressed directly in the final Bill if appropriate or in the regulations or policy statements. In relation to the issues of non-financial products the Committee **recommends** that the draft Bill be amended as follows:

[insert at 766B (6)]

For the purposes of this section, information that:

(a) is provided to a person in relation to the provision of a good or service that is not a financial product; and
(b) is not provided wholly or predominantly in relation to the provision of a financial product;

is not financial product advice.

Australia as an international financial centre

5.6 The Committee concluded that the Australian Stock Exchange (ASX) evidence raised important issues relating to the international competitive position of Australia and its role as a global financial centre. The Committee accepts the ASX advice that its concerns are vital to these matters. In this context the Committee noted that a stated purpose of the financial sector reform process was to strengthen these areas.

5.7 Accordingly, the Committee **recommends** that the final Bill or the regulations address the concerns of the ASX. In particular, the Committee **recommends** that the transitional and administrative measures suggested by the ASX be adopted.

The impact on small business

5.8 The Committee concluded that the disclosure of commissions on risk insurance products has the potential to impact unfairly on small business. The Committee supports retaining the requirement that persons selling these products are required to indicate on the Statement of Advice that they will receive a commission. However the Committee **recommends** that the requirement that a quantum be disclosed on risk insurance products (where return is unaffected by the level of commission) be removed.

Co-regulation and the position of professional bodies

5.9 The committee concluded that the concerns expressed by the Law Institute of Victoria (LIV) and the Accounting Bodies in relation to their members are valid. The Committee **recommends** that the final Bill or the regulations should clarify the position. In relation to the broader issue of co-regulation and professional bodies, the Committee **recommends** that the co-regulation model be expanded to include as wide a range as possible of other areas of the financial services sector.

Proper recognition of corporate structures and the retail/wholesale client definition

5.10 The Committee concluded that the concerns expressed by the Commonwealth Bank, the Australian Bankers' Association and others about the failure of the draft Bill to recognise that a typical Australian financial corporate structure was a conglomerate, are valid. The Committee believes that no conglomerate should be exposed to additional costs, disruption or especially capital gains tax, as a result of this apparent deficiency in the draft Bill. The Committee therefore **recommends** that the final Bill expressly provide exemptions in relation to the operation of related entities within a conglomerate. Anomalies in the distinction between wholesale and retail clients should also be addressed.

Start date of the bill

5.11 Throughout the many submissions received by the Committee the issue of starting date was continually raised with a number of organisations requesting a start date of 1 July 2001. Given the scope, magnitude and significance of the bill the Committee **recommends** that consideration be given to the timing concerns expressed by those who have made submissions to the Committee's inquiry.

Senator Grant Chapman
Chairman

MINORITY REPORT

The Labor members support the general principles encapsulated in the draft Bill. However, no recommendation can be made as to whether the Bill in the final form should be passed until the form of the final Bill is known.

Specific recommendations in relation to some of the issues identified in the report by the Coalition members of the Committee are made below. On other issues the Labor members can only make general comments, or consider them technical issues which hopefully will be resolved when the final form of the Bill is known.

The Labor members however, have a number of other concerns - such as cold calling and the manner in which disclosure is made - which they would also have liked to examine further in this inquiry. That is, this inquiry should have also addressed whether the draft Bill achieved the objective of enhancing consumer protection.

In that regard, the Labor members note that evidence was obtained from the Australian Shareholder Association and Legal Aid NSW, but understand that the Committee did not contact the Financial Services Consumer Policy Centre to ask them if they would appear before the Committee or if they would copy the submission they made to Treasury to the Committee. There was also no submission from the Australian Consumers Association. The Financial Services Consumer Policy Centre in particular represents a broad constituency of financial consumers, including bank customers, and may have assisted the inquiries of the Committee considerably.

As indicated above, it was also anticipated that the final form of the Bill would be introduced into Parliament during the course of the Committee's inquiry. This would have assisted in the examination of the new regime proposed in the draft Bill. Accordingly, the Labor members propose that a further inquiry to cover all areas of concern be conducted when the Bill is introduced into Parliament. It is hoped that all members will be genuinely consulted on dates for any hearings which may be necessary as part of that inquiry, and also on who is invited to make submissions at such a hearing.

Comprehensive Consumer Protection

The Labor members acknowledge that the draft Bill may impose additional costs on approved deposit taking institutions. The Labor members do not however, believe that this warrants excluding basic banking products from the ambit of the draft Bill.

Retaining banking products within the ambit of the Bill will better achieve the objective of uniform disclosure obligations for all financial products and will enhance consumer protection. Retail consumers of all financial products deserve equal protection and to know if there are any factors influencing the advice given to them.

The Labor members believe it would be more appropriate to identify where the Bill imposes costs which may affect the provision of banking services to regional and rural areas and attempt to minimise those costs. In this regard, the Labor members note the submission and evidence from the Credit Union Services Corporation (Australia) Limited.

Accordingly, the Labor members would recommend that Treasury give due consideration to such issues raised in various submissions as:

- the level of training and monitoring required being proportionate to function being performed;
- increasing the time in which changes in authorised representatives have to be notified to ASIC;
- permitting employees of related companies to act as representatives of the licensee without having to be authorised representatives; and
- the timing obligations of the product disclosure provisions of the draft Bill.

Extending the commencement date for the legislation, as the Labor members recommend below, would also assist financial service providers to adjust to the new regime.

Australia as an international financial centre

The Labor members support promoting Australia as a global financial centre. This requires, among other things, confidence in Australia's regulatory system. It also, as pointed out by the ASX, requires a regulatory system that is flexible enough to permit participants to respond rapidly to changes and new developments and that does not impose costs on participants which exceed the benefit from such regulation.

In this regard, the Labor members note the submission of IFSA that the requirement to lodge product disclosure statements and supplementaries "is a bureaucratic imposition with no regulatory or consumer protection imperative". Similar comments were also made by the ABA, ASIC, Westpac, JFIMA, BT and AMP.

Accordingly, if ASIC is to have no role in pre-vetting product disclosure statements, Labor members adopt the recommendation of ASIC in this matter. That is, lodgement should be required only for listed managed investment scheme and some of the non-mining primary producer managed investment schemes, where ASIC does conduct some vetting, but other than for these cases, the lodgement requirement could be removed, provided the issuer keeps the product disclosure statements for a fixed period, say 7 years.

Commission Disclosure

Several issues arise in relation to the disclosure of commission. One issue is whether the commission on risk products should be disclosed. The Labor members acknowledge the submission by the Insurance Council that the stated return on risk insurance products is unaffected by the level of commission. However, unless risk insurance products are identical, information on commission payments may be relevant to customers in determining whether the recommendations of a financial service provider have been influenced by the payment of commission and should be disclosed.

Labor members also believe that the draft Bill should give greater emphasis to directing the disclosure of commission, fees and other charges in a manner which is meaningful to consumers. Labor members believe that consumers will more readily

comprehend a dollar amount and recommend that commissions, fees and charges be disclosed in dollar terms whenever possible, or if that is not possible, in percentage terms with an "illustrative example" provided in dollar terms.

Co-regulation and the position of professional bodies

The Labor members do not support the declaration process by which professional bodies are exempted from the requirement to be licensed. A number of submissions – ASFA, SIA, ASX, the Insurance Council – stated opposition to the declaration process or recommended that ASIC consult with all the relevant and interested parties before making any declarations. Other submissions, such as from IFSA and AMP, would regard it as essential that the standards imposed on such bodies would result in the members of declared bodies being subject to exactly the same conduct, disclosure and competency requirements as licensees.

ASIC also raised a number of regulatory concerns. Most notably, ASIC said that the introduction of clause 882A may create a number of problems or gaps in regulatory coverage and is likely to be resource intensive both for ASIC and the participants involved.

The Labor members, however, acknowledge that solicitors and accountants have a system of training and statutory obligations which warrant retaining an exemption for incidental advice by solicitors and accountants in public practice. The existing exemption in section 77(5) should be retained or, as suggested by the Law Institute of Victoria, there could be a carve-out from the definition of "financial product advice" to exclude advice provided to a client as part of, or incidental to, the lawyer's legal practice.

Group Structures and the Definition of Retail Client

The Labor members identify two issues in relation to the "proper recognition of corporate structures under the retail/wholesale client".

The first issue relates to the practice of many businesses being run as a corporate group, with the consequence that the entity which is licensed may not be the entity which employs the relevant staff. A number of submissions stated that the requirement that employees of wholly owned subsidiaries be authorised individually would create a significant cost for such financial conglomerates.

The Labor members agree that the cost of authorisation for all employees of wholly owned subsidiaries would exceed the regulatory benefit. Accordingly, the Labor members recommend that the draft Bill be amended to exempt employees of wholly owned subsidiaries from the requirement to be individually authorised as representatives of the licensee, provided the licensee also assumes the obligations it would have had under its licence if those employees had been employed by the licensee.

The second issue relates to the definition of retail client. The Labor members are concerned to ensure that people who are not financially sophisticated are defined as retail clients. The Labor members particularly note the submissions of the ASX and

the National Council of Financial Adviser Associations that prescribing an amount of $500,000 in section 716G is too low relative to potential superannuation payouts. It was also submitted that such an amount should not apply to persons in receipt of compensation payments, court judgements or lottery.

Accordingly, the Labor members recommend that the any amount which may be prescribed under section 716G is regularly reviewed, indexed, or otherwise amended to reflect any increase in the average superannuation payout. Regard should also be had to the submission of the ASX that the "price" test in section 761G be based on the total costs of the transaction exceeding the prescribed amount.

Equally, the Labor members are also concerned that people who are financially sophisticated are not classified as retail clients. If this is not the case, it will unnecessarily raise the cost of providing financial services. Accordingly, the Labor members recommend that holders of financial service licences be excluded from the definition of retail client.

Commencement Date

The Labor members note that many submissions expressed alarm at a proposed commencement date of 1 January 2001.

With the delay in the introduction of the Bill to Parliament, there is insufficient time for participants to comprehend, digest and prepare for the new law if the commencement date remains as 1 January 2001. Accordingly, the Labor members recommend delaying the commencement date of the Bill to 1 July 2001.

Mr Bob Sercombe, MP

Senator Stephen Conroy

Senator Barney Cooney

Mr Kevin Rudd, MP

APPENDIX 1

LIST OF SUBMISSIONS

1	Life Agents Action Group
2	Minter Ellison Lawyers
3	Association of Superannuation Funds of Australia Limited
3A	Association of Superannuation Funds of Australia Limited
4	Dr Michael Hains
5	The Investors Club Ltd
6	Finance Sector Union of Australia
7	NRMA Limited
8	Association of Financial Advisers
9	Australian Association of Permanent Building Societies
9A	Australian Association of Permanent Building Societies
10	The Institute of Chartered Accountants in Australia and CPA Australia
11	Credit Union Services Corporation (Australia) Limited
12	Australian Finance Conference
13	Queensland Association of Permanent Building Societies Limited
14	Australian Conservation Foundation
15	Investment & Financial Services Association Ltd
16	Legal Aid NSW
17	National Credit Union Association
18	Financial Planning Association of Australia Limited
19	Investment & Financial Services Association Limited
20	Australian Bankers' Association
21	Australian Aviation Underwriting Pool Pty Ltd
22	ASIC
23	HCF Life
24	Arlington House Pty Ltd
25	Morgan Stanley Dean Witter
26	Westpac Banking Corporation
26A	Westpac Banking Corporation
27	Telstra
28	Securities Exchanges Guarantee Corporation Ltd
29	Macquarie Bank Limited
30	ANZ
30A	ANZ
31	Australian Stockbroking Limited
32	Mercantile Mutual Holdings Limited
33	Insurance Council of Australia Ltd
34	The Securities Institute of Australia
35	Australian Institute of Chartered Loss Adjusters
36	ComSuper
37	The Law Institute of Victoria

38 Asia Pacific
39 Australian Payments Clearing Association Limited
40 Austraclear
41 Jacques Martin Industry Funds Administration Pty Ltd
42 Ms Pamela Hanrahan
43 BT Funds Management Limited
44 NIBA
45 Quantum Financial Planners
46 Australian Stock Exchange
47 Donaldson Financial Planning Pty Ltd
48 APIR Systems Pty Limited
49 John Fielding
50 AMP
51 Deutsche Bank Group
52 Insurance Premium Funding Association of Australia
53 Lloyd's Australia Ltd
54 **CONFIDENTIAL**
55 National Council of Financial Adviser Associations
56 Bendigo Bank Group
57 Credit Union Services Corporation Australia Limited
58 GAB Robins
59 Association of Financial Advisers
(Supplementary to Submission Number 8)
60 AAMI
61 Joint Submission – Australian Financial Markets Association and Securities & Derivatives Industry Association
62 Commonwealth Bank Group
63 Sydney Futures Exchange Limited

APPENDIX 2

WITNESSES AT HEARINGS

Monday, 17 July 2000

Treasury

Mr Michael Willcock, General Manager, Financial Markets Division

Ms Vicki Wilkinson, Manager, Financial Services Project Unit

Ms Ruth Smith, Specialist Adviser, Financial Markets Division

Ms Susan Vroombout, Specialist Adviser, Financial Services Project Unit

Insurance Council of Australia

Mr Alan Mason, Chief Executive

Mr Philip Maguire, Deputy Chief Executive

Mr Robert Drummond, Executive Manager, Operations

Association of Financial Advisers

Mr John Hibberd, President

Mr Hugh Crawford, Member, Public Affairs Committee

Mr Mr Dugald Mitchell, Consultant

Life Agents Action Group

Mr Paul Maughan, Director

Mr Darryl Foster, Director

Mr Greg Veivers, Director

Australian Association of permanent Building Societies

Mr James Larkey, Executive Director

Mr Raj Venga, Director, Policy and Compliance

APIR Systems

Mr Andrew Hutchings, Managing Director

Mr Andrew Riley, Director

Monday, 24 July 2000

Investment & Financial Services Association Ltd

Ms Lynn Ralph, Chief Executive Officer

Mr Phillip French, Senior Policy Manager

Credit Union Services Corporation (Australia) Ltd

Mr Chris Gration, Senior Adviser, Policy and Public Affairs

Mr Luke Lawler, Senior Adviser, Policy and Public Affairs

National Insurance Brokers' Association

Mr David Squire, National Board Member and Chair of Life Committee

Mr Noel Pettersen, Chief Executive Officer

Mr John Hanks, Consultant

Association of Superannuation Funds of Australia Ltd

Ms Philippa Smith, Chief Executive Officer

Dr Michaela Anderson, Director, Policy and Research

Commonwealth Bank

Ms Sarah Goodman, Head of Group Compliance

Mrs Jill Lester, Head, Group Corporate Relations

Financial Planning Association of Australia Ltd

Mr Raymond Griffin, Chairman

Mr Ken Breakspear, Acting Chief Executive Officer

Mr Con Hristodoulidis, Senior Manager, Public Policy

Australian Financial Markets Association and the Securities & Derivatives Industry Association

Mr Kenton Farrow, Chief Executive, Australian Financial Markets Association; Managing Director, Securities and Derivatives Industry Association

Mr John Rappell, Director, Research and Policy

Australian Shareholders Association Ltd

Mr Ted Rofe, Chairman

Tuesday, 25 July 2000

Minter Ellison Lawyers

Mr Ross Freeman, Partner

Ms Julia Avis-Keast, Senior Associate

Telstra

Mr Chris Bishop, National General Manager, Credit Management

Ms Sasha Carrel, Manager, Regulatory Policy, Telstra Retail

Mr Greg Colledge, Executive Manager, Business Analysis; Finance Manager, Telstra Visa Cards

Australian Stock Exchange

Ms Christine Jones, National Manager, Market Law and Policy

Mr Alan Shaw, National Manager, Supervision

Finance Sector Union

Ms Meredith Jones, Research Officer

Ms Emma King, National Industrial Officer

Australian Bankers' Association

Mr Ian Gilbert, Director

Mr Gary Healey, Director

Bendigo Bank Group

Mr Robert Johanson, Deputy Chairman

Mr David Oataway, Company Secretary

Mr Malcolm Campbell, General Counsel

Macquarie Bank Ltd

Mr James Kruger, Lawyer, Equities Group

CPA Australia and The Institute of Chartered Accountants in Australia

Ms Anne Molyneux, Director, Intellectual Capital, CPA Australia

Mr Bradley Pragnell, Superannuation Policy Adviser, Intellectual Capital

Mr Stuart Black, Chair, Rural and Regional Issues Group

Mr Keith Reilly, Technical Consultant

Law Institute of Victoria

Mr Alan Maclean, Financial Services Committee, Law Institute of Victoria and Law Council of Australia