

## CHAPTER 2

### BACKGROUND TO THE BILL

2.1 The Financial System Inquiry was charged with providing a stock-take of the results arising from the financial deregulation of the Australian financial system since the early 1980s. The Inquiry also analysed the forces driving change in the financial system, in particular, technological development.

2.2 The Financial System Inquiry reported to the Treasurer in early 1997 and made recommendations as to the regulatory arrangements that will best ensure an efficient financial system. The Inquiry concluded that the existing complex and fragmented regulatory framework was creating inefficiencies for financial service providers and confusion for consumers.

2.3 In his second reading speech on the current Bill the Minister, the Hon. Joe Hockey MP, noted that the Financial System Inquiry report, known as the Wallis report, had recommended the introduction of a single licensing regime for all financial sales, advice and dealing and the creation of a consistent and comparable product disclosure framework. It had also suggested that such changes would generate substantial benefits for both the industry and consumers.

2.4 Responding to the Inquiry's report, the Treasurer, in March 1997, announced the Corporate Law Economic Reform Program which he stated would review fundamentally key areas of regulation which affect business and investment activity and make recommendations for improvement.

2.5 The Corporate Law Economic Reform Program was intended as a response to developments in the international and domestic business environments which had made the streamlining of Australia's corporate law necessary if the Australian economy was to meet the demands of contemporary business.

2.6 The various elements of the Corporate Law Economic Reform Program were developed after consultation with the business community and the Business Regulation Advisory Group. It is the sixth stage of this Reform Program which ultimately has resulted in the production of the Financial Services Reform Bill which is the subject of this Committee's report.

2.7 A position paper—*Financial Markets and Investment Products*—released in December 1997 was followed by a consultation paper, titled *Financial Products, Service Providers and Markets—An Integrated Framework* of March 1999. An extensive consultation process then followed. An exposure draft of the Financial Services Reform Bill was then released in February 2000.

2.8 The Parliamentary Joint Committee on Corporations and Securities held an inquiry into the exposure draft Bill and tabled its report on 14 August 2000. In this

report the Committee made a number of recommendations regarding the exposure draft for the Government to consider during its preparation of the final form of the legislation.

2.9 The current version of the Financial Services Reform Bill, which is an integral part of the Government's legislative response to the Financial System Inquiry, has been modified in the light of the recommendations of the Committee's report of August 2000, and extensive consultation which the Department of the Treasury carried out in relation to the exposure draft Bill.

2.10 The Committee's recommendations on the exposure draft Bill and the Government's response to them, are discussed below.

### **Changes to the exposure draft Bill**

2.11 The Government's response to the Committee's report indicated that the Government either fully or partially accepted the majority of its recommendations. This has resulted in key changes being made to the exposure draft Bill.

2.12 The Committee notes that a number of other changes between the exposure draft Bill and the current Financial Services Reform Bill resulted from the extensive consultation that the Department of the Treasury conducted on the exposure draft Bill.

2.13 The eight recommendations made by the Committee in its report of August 2000, and the Government's response to those recommendations, are discussed below.

#### *1) Passage of final Bill*

2.14 The Committee concluded that there was general support for the aims of the exposure draft, however, most submissions included suggestions for improving the manner in which the Bill had been drafted. Subject to these drafting changes, and the Committee's other recommendations, the Committee recommended that the draft Bill proceed and be considered the foundation for a final Bill that would be passed by the Parliament.

2.15 The Government welcomed the recommendation to pass a final version of the Financial Services Reform Bill and stated that it would finalise the drafting of the final Bill as soon as practicable. The Bill currently before the Committee is the product of that work.

#### *2) Adverse effects of the draft Bill on rural and regional areas*

2.16 The Committee concluded that there was considerable disquiet among financial institutions concerning the inclusion of basic banking products within the purview of the exposure draft Bill. This inclusion was regarded as imposing requirements on approved deposit taking institutions which could cause these institutions to terminate services, notably those offered in rural areas, because those services would become non-viable.

2.17 The termination of the provision of basic banking products in rural areas would have an unacceptable effect on local rural communities. In cases where such services were offered on an agency basis by another business, the termination of the agency could result in the business operating the agency also ceasing to trade.

2.18 The disclosure and training requirements of the draft legislation, while appropriate for more complex financial products, were found by the Committee to be inappropriate for basic banking products where few concerns had been expressed about any shortcomings in consumer protection. The Committee also recognised that imposing such requirements on basic banking products was not in accordance with the express intent of the Wallis Inquiry on this matter.

2.19 The Committee consequently recommended that the exposure 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).

2.20 The Government recognised the value of the Committee's suggestion and agreed to amend the exposure draft Bill so that deposit products offered by authorised deposit-taking institutions, for terms of 2 years or less with no management or break fees, would not be subject to the financial services guide requirements or requirements to provide statements of advice. This amendment would ensure that the final Bill's requirements apply in such a way that it recognises that basic deposit products are generally well understood by retail consumers and that consumers can get their money back on demand.

2.21 The Government also advised that it intended to make amendments to the exposure draft Bill's definitions of financial product advice and dealing, to ensure the requirements for licensing and authorisation are more tightly focussed. This would ensure that activities commonly engaged in by tellers, such as the accepting of moneys for deposit or the giving out of moneys from deposit accounts, would not be caught by the Financial Services Reform regime.

2.22 The Government noted that the Committee's report highlighted concerns about the Bill's competency requirements for representatives, such as tellers or employees of third party agents. In its response to the Committee's report, the Government stated that these concerns were unfounded and did not warrant the wholesale removal of deposits and means of payment from the exposure draft Bill.

2.23 The Government's response stated that the intention of these competency requirements was not to force every representative to be competent to provide full financial planning services. Rather, representatives would only have to be competent to provide the services they actually provide in the course of their regular duties—no more and no less. The Government stated that it did not expect industry participants who are adequately trained and competent to provide the services they now provide to have to undertake significant extra training to meet the draft Bill's competency requirements.

2.24 The Government also believed that the final form of the Financial Services Reform Bill would not hinder the operation of Rural Transaction Centres or distribution of deposit products through third-party agents such as newsagents or pharmacists in country Australia.

### 3) *Information economy and e-commerce*

2.25 The Committee concluded that e-commerce and other issues, particularly the issue of advice on non-financial products, should be addressed directly in the final Bill, if appropriate, or alternatively in the regulations or policy statements. In relation to non-financial products the Committee therefore recommended that the exposure draft Bill be amended as follows:

[ insert at 766B (6) of exposure draft Bill ]

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.

2.26 The Government, in its response to the Committee's Report, welcomed the support for the information economy and e-commerce. The Government, however, stated that it did not believe it needed to amend the definition of financial product advice in the way recommended by the Committee, in order to address the concerns raised in evidence before the Committee on the information economy and e-commerce.

2.27 The Government therefore stated that the exposure draft Bill would be amended but only so as to clarify the application of its requirements in a range of e-commerce situations. For example, the Bill would be amended to make it clear that a person who merely provides a communication service through which a consumer makes a non-cash payment is not the provider of the non-cash payment facility.

### 4) *Australia as an international financial centre*

2.28 In relation to the exposure draft Bill, the Committee concluded that the evidence of the Australian Stock Exchange (ASX) raised important issues regarding Australia's international competitive position and role as a global financial centre. The Committee therefore recommended that the transitional and administrative measures suggested by the ASX be adopted.

2.29 The Government responded by declaring that it was keen to enhance Australia's role as an international financial centre but it was not convinced that the examples cited in evidence to the Committee by the ASX will have the effect of undermining the future of Australia's markets. In particular the Government's response stated that:

- the object of provisions relating to the regulation of foreign-based markets operating in Australia is facilitative—to ensure that those markets which are subject to an appropriate regulatory regime overseas are not, in addition, subject to the full rigours of the Australian regulatory regime. The

intention is that the regulation of such markets in Australia and overseas, when taken together, be equivalent to the regulation of a comparable market which is licensed only in Australia;

- the purpose of requiring that Australian incorporated bodies which operate a market or clearing and settlement overseas be licensed in Australia is to ensure that Australia does not lend its name to doubtful operators who may mislead overseas investors by implying that, since they are incorporated in Australia, they are regulated in Australia. Such a situation would adversely affect Australia's reputation as an international financial centre;
- the Government remains committed to providing regulation of financial markets through a combination of self-regulation, and regulation by the Minister and ASIC. A wide power of delegation to the regulator, ASIC, is necessary to ensure flexibility in the operation of the new legislation into the future, but it is expected that the Minister will continue to be the decision-maker in relation to the major markets.

2.30 The ASX raised in evidence the issue of increasing the shareholder limitation in the Exchange from 5 per cent to 15 per cent in line with the banking sector, with the possibility of a larger proportion, subject to a 'fit and proper' person test. The ASX also pointed to the need for an even-handed competitive environment.

2.31 The Government regarded this point as a valid criticism and so, on 10 October 2000, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, announced that the Government would raise the shareholder limitation in the Australian Stock Exchange to 15 per cent. The Government stated it would consider permitting a shareholding larger than 15 per cent if it were in the national interest. Minister Hockey also stated that the same shareholding limitations would apply to other financial markets and clearing and settlement facilities that are of national economic significance.

2.32 Minister Hockey announced that these changes to shareholding limitations would be included in the final version of the Financial Services Reform Bill and would complement the 'fit and proper' person test applying to controllers and senior managers of Australian markets and clearing and settlement facilities.

#### *5) The impact on small business*

2.33 The Committee concluded that the disclosure of commissions on risk insurance products, required by the exposure draft Bill, had the potential to impact unfairly on small business. The Committee supported retaining the requirement that persons selling risk insurance products be required to indicate that they will receive a commission, however, the Committee recommended removing the requirement that the quantum of the commission be disclosed automatically.

2.34 The Government's response rejected this particular recommendation.

2.35 The Government stated that the purpose of disclosure was to help the consumer identify potential influences on the advice given, or potential conflicts of interest, which the adviser may have in recommending a specific product. The Government's view was that consumers need to know the quantum of commissions in order to assess the seriousness of possible conflicts an adviser may have in recommending a product.

2.36 The Government regarded the disclosure of benefit or advantage as essential to ensure that consumers were provided with information that will help them make an informed choice about whether to purchase a product or not. According to the Government's response, the disclosed information would help the consumer evaluate any possible influences on the adviser in recommending a particular product.

*6) Co-regulation and the position of professional bodies*

2.37 The Committee noted the concerns expressed by the Law Institute of Victoria (LIV) and the Accounting Bodies about the exposure draft Bill. The Committee recommended that the final Bill or the regulations clarify the position of members of the Law Institute of Victoria (LIV) and the Accounting Bodies. The Committee also recommended that co-regulation be expanded to include as wide a range as possible of other areas of the financial services sector.

2.38 The Government also rejected this recommendation.

2.39 The Government's response to the Committee's Report stated that, from consumers' perspective, the loss they might suffer from poor financial advice given by, for example, an accountant who provided that advice incidentally to accounting services, is no less serious than the loss they would suffer if the poor advice had been given by someone whose main activity was the provision of financial advice, for example, a financial planner.

2.40 The Government therefore found it necessary to retain provisions in the Bill requiring anyone who provided defined financial services be competent to do so. This requirement would apply irrespective of whether the service providers call themselves insurance agents, financial planners, accountants or lawyers. Generally speaking, providers of financial advice would require an Australian Financial Services Licence.

2.41 In light of submissions on the exposure draft Bill, the Government did amend the definitions of financial product advice and dealing, to ensure that it would be clear what activities would attract the operation of the Bill.

*7) Proper recognition of corporate structures under the retail/wholesale client definition*

2.42 The Committee concluded that the concerns expressed by the Commonwealth Bank, the Australian Bankers' Association and others about the failure of the draft exposure Bill to recognise that a typical Australian financial corporate structure was a conglomerate, are valid. The Committee therefore recommended that the final Bill

expressly provide exemptions in relation to the operation of related entities within a conglomerate. The Committee also recommended that anomalies in the distinction between wholesale and retail clients be addressed.

2.43 The Government responded to this recommendation by making amendments to the Financial Services Reform legislation to accommodate conglomerate structures where staff are employed by a single corporate entity within the group.

2.44 The Government stated that, in relation to the potential capital gains tax consequences for existing industry participants in moving to the new licensing regime contained in the Financial Services Reform Bill, consultations have been occurring on this issue since February 2000. The Government also stated that it would consider whether any legislation would be necessary to deal with the tax consequences as a result of the Financial Service Reform Bill.

2.45 The Government response also indicated that, in relation to the retail/wholesale client definition, amendments would be made to align it more closely with the current definition in the *Corporations Act 2001* and to clarify that Financial Services Licensees and prudentially regulated bodies are wholesale clients.

#### 8) *Start date of the bill*

2.46 Throughout the many submissions received by the Committee on the exposure draft Bill the issue of starting date was raised. The Committee recommended that consideration be given to the timing concerns raised by submitters:

- to avoid the adverse effects on the delivery of financial services in rural and regional areas;
- to ease the development of e-commerce and clarify the definition of financial product;
- to address issues raised relating to the international competitive position of Australia and its role as a global financial centre;
- to remove the requirement of disclosing the quantum of a commission on risk insurance products where return is unaffected by the level of commission;
- to clarify the position of legal and accounting practitioners and to expand the co-regulation model with respect to professional bodies;
- to address the anomalous position of employees in conglomerate corporate structures and the anomalies in the distinction between wholesale and retail clients;
- to address the timing concerns in relation to the start date of the new regime.

2.47 In its response the Government noted the Committee's recommendation that consideration be given to the timing of the Financial Services Reform regime to allow industry sufficient time to comply with the new regime. The Government stated that it



was keen to finalise, introduce and secure passage of the draft Bill as soon as possible, and that it would take account of the Committee's views, and those of the regulator and interested industry stakeholders, when determining when to commence the legislation.

2.48 The Government also noted that it proposed transitional provisions under which existing industry participants will be able to comply with some current requirements rather than the new law for a period of up to 2 years.

### **Summary**

2.49 The Minister declared that the current Bill would 'enable financial service providers to reap the efficiencies and cost savings' identified by the Financial System Inquiry.

2.50 The Bill aims to give effect to the Minister's declaration:

- by introducing a 'harmonised licensing, disclosure and conduct framework for all financial service providers';
- by establishing a 'consistent and comparable financial product disclosure regime';
- by creating a 'streamlined regulatory regime for financial markets and clearing and settlement facilities'.

2.51 The Bill recognises that it is no longer possible for different financial institutions, services and products to be regulated under separate regulatory frameworks. The Bill therefore substitutes a single framework to regulate financial institutions, services and products in place of the current separate regulatory frameworks. The Bill will thus enable Australia's regulatory framework to keep pace with current developments in the financial services industry.

2.52 The Bill provides for the removal of regulatory barriers to the introduction of technological innovations and thus assists Australia's financial services industry to meet the technological challenge posed by the spread of e-commerce. The Bill's objective is to ensure that Australian financial service providers that seek to compete in the global marketplace are not disadvantaged under Australia's domestic regulatory framework.

2.53 According to the Minister, the 'streamlined regulatory regime proposed in the Bill aims to reduce the compliance costs associated with carrying on a financial services business.' The Bill therefore would bring particular benefits to financial institutions that seek to provide their clients with a full range of financial services and products. However, it has been 'carefully crafted' to ensure that specialist providers and small businesses will not be disadvantaged.

2.54 Another purpose of the Bill is to benefit consumers:

- by introducing a consistent framework of consumer protection;
- by enhancing the capacity of consumers to understand and compare different financial products and evaluate financial advice;
- by ensuring that consumers can access appropriate complaint handling mechanisms for resolving disputes with financial service providers.

2.55 The Bill provides protection for individual and small business consumers without imposing higher costs on wholesale transactions between sophisticated professional investors that operate in a competitive global market.

2.56 The regulatory framework is designed to be capable of flexible implementation so that it can apply differently to different products where this difference can be justified within its overall objectives. For example, basic deposit products will be subject to less intensive regulation than more complex investment products. Thus the Bill aims not to jeopardise the cost-effective provision of basic banking services, especially in rural and regional areas.

2.57 The Bill also provides financial service providers with the flexibility to adopt corporate structures and distribution channels that best meet their commercial objectives.