CHAPTER 5

POLICY ISSUES RAISED BY THE BILL

Introduction

5.1 As recorded in the previous chapter, the key objectives of the Financial Services Reform Bill 2001—to benefit the consumer through introduction of a single licensing and standardised disclosure regime for the financial services sector—has the overall support of consumer representatives and industry stakeholders. At the same time, however, their evidence to the Committee was that the Bill may have some unintended or adverse consequences for particular industry sectors or for consumers.

5.2 Some of the issues identified by industry and consumer groups were the same as, or permutations of, those identified in the Committee's report on the draft Bill. Others, such as the provisions on the recording of some telephone conversations during takeovers and the repeal of Corporations Law exemptions for journalists from licensing requirements, were entirely new to the legislation.

5.3 While these last matters prompted requests for significant amendments to the legislation, most of the recommendations made to the Committee require only minor modification of the Bill, or suggest a need for clarification in the regulations. This chapter of the report provides an overview and an analysis of industry, advisory body and consumer response to the Bill.

Overview of issues raised

5.4 Despite acknowledged improvements over the draft Bill, a majority of submissions called for still finer definition of key terms within the legislation—of the meaning of financial products, of financial advice, and for more specific information about disclosure and licensing requirements arising out of these definitions.

5.5 Many criticisms of the Bill were anchored in the technical and practical implications of its aspects for particular industry sectors. Small businesses in the life insurance industry, for example, continued to express concerns that commission disclosure requirements, coupled with the new single licensing arrangements, would affect their viability. The telephone disclosure requirements were a problem for the travel, health and motor vehicle insurance industries which use telephone, or call centres, as their main means of product promotion.

5.6 There were also a number concerns in relation to the Bill's regulation of the superannuation industry, with potential unintended consequences of the threshold set for the 'product value test' for some superannuants, and the classification of pooled superannuation trusts (PSTs) as retail, indicating to some submitters a 'serious flaw' in the legislation. Training requirements to provide financial advice remained a key concern to industry and consumer groups generally, and particularly for

superannuation board trustees and for some long term insurance industry members who took their training prior to 1995. The Committee also heard that the present drafting of the Bill does not take into account the situation of corporate and industry superannuation funds which had previously been treated separately as 'not-for-profit' funds under the *Superannuation Industry (Supervision) Act 1993* [the SIS Act].

5.7 Uncertainties about the licensing regime focussed on definition of exemptions and authorisation issues. Lawyers and accountants were concerned about the breadth and operation of exemptions for the giving of incidental advice. The implications of the proposed licensing regime for foreign companies providing financial services within Australia also attracted comment, with the Australian Stock Exchange (ASX) suggesting that the Bill would not consolidate Australia's status as a centre for international financial services as intended.

5.8 Meanwhile, consumer groups judged that while the regime was ostensibly aimed at gaining the confidence of, and benefiting consumers, a number of aspects of the Bill did not appear to be drafted with the consumer's good in mind. In particular, these groups contested proposed exemptions from requirements under the disclosure and licensing regimes, and so opposed requests made by some industry groups to extend the application of these exemptions.

5.9 Another group of submitters proposed that the disclosure regime could be used to promote the growth of the ethical investment in Australia. These submitters stated that this was an important issue for Australian consumers who, surveys had shown, supported developments in this area.

5.10 The Bill also introduced two new proposals relating to telephone recording of shareholder canvassing during takeover bids and regulation arrangements for financial reporters, through the repealing of the media exemption in the Corporations Law. These attracted particular criticism for being framed without consultation with relevant industry participants. In response to this criticism, and practical issues identified, the Government announced that it would modify the legislation by amendment or regulation.

Revoking of the media exemption

Introduction

5.11 At present the reporting of financial matters by the media is exempted from licensing requirements under section 77 of the Corporations Law, if the investment advice is offered in a newspaper or periodical which is available without subscription. The exemption does not apply to publications with the principal purpose of offering investment advice about securities or of providing securities reports. The scope of the exemption is described and supported by ASIC's Policy Statement PS 118. The effect of the provision is to provide a wide-ranging exemption to media organisations from the licensing and associated provisions in Chapters 7 and 8 of the Corporations Law, apart from those relating to registers of interests in securities.

5.12 The Bill proposes the repeal of the exemption so as to bring all providers of financial advice under the same regulatory and disclosure regime. As the Department of the Treasury explained, the fundamental basis of the Bill is the imposition of a unified regulatory regime based on generalised principles that apply across the financial services industry without any detailed application to any particular sector. The revoking of the media exemption was, therefore, incidental to the 'philosophy' of the new regime as drafted, and so redundant under its operation.[1]

5.13 However, the removal of the exemption alarmed Australia's media community. It reported a lack of consultation about the proposed changes and saw deep conceptual and practical problems arising for the media under the new regime. Organisations also noted that the Explanatory Memorandum to the Bill made no particular mention of the revoking of the media exemption, or reference to the regime's intentions towards the media.

5.14 The Committee received submissions from key stakeholders in the Australian newspaper and broadcasting industry, both private and public sector, and also from Reuters, the UK-based international press agency, outlining these concerns. In recognition of the degree of unease about the legislation, the Committee invited representatives from Fairfax Holdings Limited, News Limited and from the Federation of Australian Commercial Television Stations and the Special Broadcasting Service (SBS) to give evidence in Sydney on 13 June 2001.

Ethical and international implications

5.15 For media organisations, the removal of the exemption under the Corporations Law was not a necessary or appropriate consequence of financial and regulatory reform. Fairfax Holdings Limited and News Limited noted that the Wallis inquiry had made no recommendations in this regard and that ASIC, commenting in its policy statement on section 77 in January 2000, had stated that it 'did not see any net regulatory benefit' in seeking law reform to remove the exemption.[2] Fairfax, News Limited, the SBS and the Australian Press Council all agued that there is no need for change as the current framework works well with no record of complaint from consumers.[3]

5.16 An underlying concern for media representatives was that the Bill, in setting up a regulatory regime to protect consumers against misleading advice, may actually counter that aim by limiting the freedom of the press to fully inform the public about financial products and services. In this regard, they argued, the Bill contradicts the guiding principal of freedom of information in a democracy, where the key role of the media is to provide readers with a range of viewpoints supplemented by factual analysis so that they might form their own conclusions.

1 Committee Hansard, p. 268.

2 Submission no. 62, p. 3, and Submission no. 70, p. 7.

3 Submission nos 62, p. 2; 70, p. 3; 80, p. 3; 74, p. 1.

5.17 At hearings, Mr Bruce Wolpe of Fairfax stated that, in revoking the exemption, the Bill takes Australia into 'dangerous territory', where the fundamental integrity of press freedom is no longer preserved by statute. He asserted that this was 'an irreparable step backward' for the protection of journalism—and hence the consumer's right to be informed—in Australia. News Limited's Mr Warren Beeby added that without a constitutional commitment to freedom of speech or a Bill of Rights the exemption provides the only certainty for the media.[4]

5.18 These views were widely endorsed by other media organisations, with SBS also noting that the Bill would compromise its editorial independence, as established by the SBS Act, through subjecting SBS programming and editorial decisions to a government licensing regime.[5]

5.19 Reuters further pointed out that Australia would be alone in the world if it chooses to subject its media to licensing and supervision by a financial services regulator. It noted that the UK, in implementing a financial regulatory reform program recently, had retained an express statutory exemption for the media from the UK's investment advice regime.[6] At hearings, News Limited's Mr Beeby told the Committee that he understood that similar exemptions also applied in the United States, in Canada, New Zealand, Hong Kong and Singapore.[7]

5.20 Reuters also advised that, in pursuing the current proposal, Australia would contravene its commitments to the World Trade Organisation's General Agreement on Trade in Services—GATS. Under GATS, Australia must not impose limitations or restrictions on market opportunities or existing benefits to financial service industry participants such as suppliers of financial information services.[8]

5.21 In this regard, the Federation of Australian Commercial Television Stations (FACTS) and the Australian Subscription Television and Radio Association (ASTRA) warned that the requirements would affect Australia's competitiveness as a hub for international financial activity. The organisations identified a number of operational hurdles which they predict will act as disincentives for broadcasters to research and report on Australian markets, driving down both the amount and the quality of information available to the consumer.[9]

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4 Committee Hansard, p. 171.

5 See News Limited Submission no. 70, p. 5; Australian Press Council Submission no. 74, p. 1; Broadcasters Submission no. 79; and SBS Corporation Submission no. 80, pp. 2–3.

6 Submission no. 71, p. 1. On request of the Committee, Fairfax tabled a copy of the wording of the exemption on 13 June 2001; see Committee Hansard, p. 172.

7 Committee Hansard, p. 187.

8 Submission no. 71, p. 3.

9 Submission no. 79, p. 4.

5.22 Alternatively, News Limited predicted Australian news provision will become less competitive with overseas providers who will probably, due to difficulty of enforcement, escape the regime.[10]

Operational concerns

5.23 Concerns about the media's ability to deliver accustomed services after the implementation of the Bill are anchored in the uncertainties raised by the Bill's definition of financial advice and how the proposed vetting by ASIC of information could feasibly work in a busy news environment.

5.24 At hearings in Canberra on 27 June 2001, Ms Sue Vroombout, Manager of the Product Disclosure Unit, Financial Markets Division, the Department of the Treasury, told the Committee that the status of media providers hinges on the Bill's definition of financial advice. She advised that if a representative of a media organisation offers general financial advice—that is, makes a value judgment about a particular product, in the course of doing business—then the provider would be caught by the requirements and should take steps to comply.[11] The options would include the organisation taking out a license and having their journalists authorised, or the journalists themselves being licensed.[12]

5.25 Media organisations were satisfied with requirements that those in the media who are being remunerated for giving financial advice should be licensed, as is presently required, but they saw real difficulties emerging in the 'grey areas'. These are where journalists are reporting the opinions of, or are interviewing, other experts, or indeed any public figure who might express a view that could be read as influencing the audience.

5.26 Reuters noted that, under policy advice from ASIC, the media would have to monitor every journalist or article on a case by case basis to ascertain whether or not the newsmaking would fall within the requirements of the licensing regime.[13] News Limited saw that ASIC's task will not be easy, as the distinction between 'fact' and 'opinion' in a media context will be difficult to make and administer, especially given the journalistic process of quoting advice from others.[14]

5.27 In this context, SBS forecast a nightmare scenario where advice would potentially have to be sought from ASIC about the status of any program (even non-business programs) produced in 68 languages by 68 separate presenters to determine whether it might breach the regulations.[15] Reuters concluded that the regime will

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10 Submission no. 70, p. 7.

11 Committee Hansard, p. 268.

12 Committee Hansard, p. 269.

13 Submission no. 71, p. 2.

14 Submission no. 70, p. 5.

15 Committee Hansard, p. 176–77.

cause 'immense practical difficulties' for news organisations which have clients who rely upon the reporting of market sensitive developments with the greatest possible speed and accuracy.[16]

5.28 A key issue for the media arising from this is whether or not journalists and presenters will be exposed to an increased possibility of criminal action because of the difficulties of ascertaining whether or not they, or their employers, will be required to be licensed to carry out their professions. Media organisations pointed out that the type of regulatory regime proposed is unnecessary as the media have their own well-established editorial guidelines which require, for example, disclosure of interests.[17]

5.29 SBS also noted that compensation arrangements proposed under the Bill are inconsistent with treatment of the media under the Trades Practices Act. Under that Act, an exemption ensures that media reporting is not unreasonably limited by the consumer protection provisions.[18] SBS Head of Policy, Ms Julie Eisenberg, suggested that, under the new regime, when 'the media was being the media', ie reporting information, it should be allowed equivalent protection.[19] News Limited, FACTS and ASTRA saw that if exemptions are not provided, then market transparency will be reduced with organisations adopting a conservative line to avoid any possible prosecution.[20]

5.30 Given these factors, Fairfax and others asked why the current law and regulations, which can be applied 'clearly and unambiguously' in production of news and financial service publications, should be superseded by arrangements so cumbersome and uncertain.[21] Fairfax asked that the presumption established by the exemption should be reinstated in statute, and not dealt with through regulation, to take the media out of the ambit of the Bill.[22] FACTS and ASTRA saw that ASIC's Policy Proposal should make clear that its policy stance under PS 118 will still apply under the regime.[23] SBS considered that the current law and regulations should be reinstated under the new regime and requested the opportunity to engage in consultations before the legislation was finalised.[24]

5.31 In recognition of the concerns brought to the inquiry by the media, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, wrote twice

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16 Submission no. 71, p. 2, and see also News Limited Submission no. 70, p. 5.

17 See for example, News Limited Submission no. 70, pp. 6–7; Reuters Submission no. 71, p. 1; and Australian Press Council Submission no. 74, pp. 2–3.

18 Submission no. 80, p. 3.

19 Committee Hansard, p. 174.

20 Submission no.70, p. 7, and Submission no. 79, p. 4.

21 For example, see Submission no. 62, p. 5.

22 Committee Hansard, p. 184.

23 Submission no. 79, p. 5, and see Committee Hansard, p. 183.

24 Submission no. 80, pp. 3–4.

to the Committee Chairman addressing issues raised.[25] In an attachment to his first letter, the Minister advised that ‘it is not the Government’s intention to change the practical effect of licensing requirements for media organisations’.[26] He stated that, in view of the media’s concerns, the Government was considering an exemption for the media in the regulations or through the means of ASIC’s exemption powers.[27]

5.32 The second letter announced the Government’s intention to draft a regulation which would preserve the presumption that general advice provided through the media will not require a license, subject to certain disclosure requirements.[28] At hearings on 27 June 2001, the Department of the Treasury confirmed that the regulation was being drafted. Ms Vroombout stated that it is intended that the regulation will exempt the media under the definition of general advice, as do current arrangements.[29]

Telephone tape recording proposal

Introduction

5.33 The Bill contains a general requirement for a bidder or target to record all telephone calls made during a takeover bid period to holders of securities in the bid class. The stated objective of the proposal is to provide a greater level of protection to small shareholders from breaches of the Corporations Law, especially in regard to misleading or deceptive conduct. The proposal would require shareholder canvassers to keep a taped record of every outbound conversation with shareholders for a period of twelve months.

5.34 Industry participants submitted that the proposal was unnecessary and unjustified, having been formulated without any consultation with affected businesses. They noted that there is no international precedent for the proposal and that it could severely inhibit takeover activity in this country. They also protested that the Bill was not targeted strategically to realise its objective of protecting small shareholders. Under the present drafting, all communications with sophisticated (or wholesale) investors would have to be recorded. Submissions argued that this would compromise confidentiality essential to business, and would establish precedents for intrusion in an already tightly regulated industry. It would also impose unmanageable operational requirements such as the archiving of vast quantities of recorded material.

5.35 The Committee also heard that the industry is well established in Australia and operates under strict self-regulation, designed to ensure customer confidence and to prevent any incidence of misleading advice for which the operators would be liable.

25 Received and tabled on 13 and 25 June 2001, respectively.

26 Attachment to letter to Senator Grant Chapman, Chairman, Parliamentary Joint Committee on Corporations and Securities, dated 13 June 2001.

27 Letter to Senator Grant Chapman, Chairman, dated 13 June 2001, p. 2.

28 Letter to Senator Grant Chapman, Chairman, Parliamentary Joint Committee on Corporations and Securities, dated 25 June 2001, pp. 2–3.

29 Committee Hansard, p. 270.

Evidence was received from established operators which conduct shareholder canvassing campaigns; CDM Telemarketing, which runs a call centre specialising in communications during bidder/target situations, and Georgeson Shareholder Communications, the world's largest global proxy solicitation company.[30] Their views were endorsed by the Law Council of Australia, International Banks and Securities Association of Australia, the Securities Institute of Australia, and the Chartered Secretaries Australia.[31]

A 'self regulating' industry

5.36 At hearings on the 14 June, Managing Director of Georgeson Shareholder Communications, Mrs Maria Leftakis, told the Committee that shareholder telephone canvassing, which has been used in Australia since 1983, has developed quite different characteristics and conventions from other types of shareholder or investor telephone canvassing, such as for financial product marketing or sales calls. Mrs Leftakis explained that shareholder telephone canvassing—where people are being asked to accept an offer or to vote their shares during takeovers, mergers and transactions—is a low profile process in which confidentiality is a priority. During the takeover process, the shareholder discusses private investment business and the information gathered is never made public.[32]

5.37 To safeguard the position of both the caller and the client, Georgeson Shareholder and CDM Telemarketing submitted that they have adopted a well developed self-regulation framework. This includes giving the shareholder the opportunity to opt out at the start of the call, and provision of standard scripts and Frequently Asked Questions (FAQ) lists, which are vetted by internal and, sometimes, external experts before delivery to every shareholder contacted. The calls are then closely monitored by supervisors and the callers subject to strict operational rules that prohibit them from varying the script, including to offer comment, opinion or casual observation.[33]

5.38 Given this, Georgeson Shareholder and other submitters took the view that the legislation seems to have been drafted with little knowledge of the actual operations or profile of the industry it proposes to regulate. All confirmed, for example, that there is no record of complaint in the industry—with no cases being bought before ASIC, the Trade Practices Commission or reported by the media.[34]

5.39 In its submission Georgeson Shareholder further noted that the only recorded incidences of dispute related to shareholders being unhappy about a takeover bid, or

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30 Submissions nos 1 and 20.

31 Submission nos 21; 24 and 24A; 58 and 65

32 Committee Hansard, pp. 238–39.

33 Committee Hansard, p. 239, and see CDM Telemarketing Submission no. 20, p. 1, and the Securities Institute of Australia, Committee Hansard, pp. 166–67.

34 See for example submission nos 1, p. 3; 20, p. 1; and 21, p. 2.

objecting on grounds of their privacy being transgressed. The submission records that the incidence of such calls is approximately 2 per 100 000 phone calls. The number of such incidents reported by the aggrieved shareholder to the client is about 1 per 500 000 phone calls.[35] CDM Telemaketing agreed that the incidence of these types of complaint is extremely low.[36]

5.40 At hearings, Mrs Leftakis also alerted the Committee to section 995 of the Corporations Law which explicitly prohibits:

> a person from engaging in conduct which is or is likely to be misleading or deceptive in, or in conjunction with among other things, the making of takeover offers or a takeover announcement, or the making of an evaluation of, or of a recommendation in relation to, takeover offers or offers, or offers constituted by a takeover announcement.[37]

She noted that this, in combination with the consistent record of successful self-regulation exhibited by the industry since at least 1995, has ensured that the consumer protection the legislation aims to achieve is already taken seriously by shareholder canvassers.[38]

Operational difficulties

5.41 In addition, submitters stated that if the proposal goes ahead as drafted it will impose possibly insurmountable difficulties on the industry. Primary among these was the scope of the proposal. In its preliminary submission, IBSA remarked on the Bill's failure to limit the requirement to small investors.[39] The Law Council of Australia predicted many unintended consequences in the proposal's failure to differentiate between mass communications with retail shareholders, and more specific communications with strategic or institutional shareholders. The Council also noted that the Bill does not clearly define which telephone calls will be regarded as being made by the bidder or target during a bid period.[40]

5.42 IBSA advised that this last problem will complicate the already great practical difficulties in ensuring that tape recording equipment is available to record conversations of all types, including regular business calls, in all situations and by all methods, such as when using a mobile phone.[41] In this regard, submissions rejected the Government's assertion that the taping of telephone calls will be the most 'straightforward and cost-effective means' of realising consumer protection

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35 Submission no. 1, p. 4.

36 Submission no. 20, p. 1.

37 Committee Hansard, p. 241.

38 Committee Hansard, p. 241.

39 IBSA Submission no. 24, p. 1.

40 Submission no. 21, p. 4.

41 See IBSA supplementary Submission no. 24A, p. 3.

objectives. Witnesses reported significant costs will be involved, with Georgeson Shareholders estimating an outlay of at least $200 000 if a company has digital telephony, or $600 000 if it does not, with little benefit to the consumer.[42]

5.43 The proposal was also thought to impose other hurdles for the future of the industry. As noted, privacy is regarded as a priority in the takeover process. Georgeson Shareholders asserted that requirements to advise clients that their discussions were being recorded would be a strong disincentive to many to continue the call, with inevitable effects on the takeover process and shareholder canvassing industry.[43] The Securities Institute of Australia was also concerned that telephone monitoring would inhibit takeover activity and set a precedent for undue regulation.[44]

5.44 Finally, IBSA noted that some banks have a policy of not recording calls, even in dealing rooms, and that the significant costs involved in setting up and continuing to comply with the requirements will undermine Australia's potential to compete as a global finance centre.[45] In this regard, the Law Council of Australia advised that the proposal was inconsistent with global practice and that, in an era of globalised markets, Australia should be cautious about adopting it, given it has not been considered in any other comparable jurisdiction.[46]

5.45 Given these factors, IBSA asserted that to introduce the proposal would be counter to the interests of the industry, introducing unnecessary costs and inconvenience for market participants without affording advantage to small shareholders. Its preferred solution was to refer the proposal to the Companies Securities and Advisory Committee for proper analysis and advice.[47] Georgeson Shareholder stood on the 'unambiguously clean' record of the industry in rejecting the need for regulation over and above that provided by self-regulation and the Corporations law. [48] However, given the Government's concerns, these firms, among other submitters, suggested some possible alternatives to the proposal.

Possible alternatives

5.46 Georgeson Shareholder, along with CDM Telemarketing, recommended that the sales scripts could be lodged with ASIC prior to the commencement of any campaign.[49] However, Georgeson cautioned that this was intended only as 'a measure of good faith'. It did not consider that ASIC should be involved in actual assessment

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42 Committee Hansard, p. 242, and see IBSA Submission no. 24A, p. 3.

43 Committee Hansard, p. 240.

44 Submission no. 58.

45 Supplementary Submission no. 24B, pp. 1–2.

46 Submission no. 21, p. 3.

47 Submission no. 24A, p. 4.

48 See Committee Hansard, p. 242.

49 Submission no. 20, p. 2, and Committee Hansard, p. 242.

of the scripts, as the time needed for such an appraisal would not be feasible given that some campaigns are run at very short notice.[50]

5.47 The Securities Institute of Australia and IBSA also saw that ASIC might play a role in adopting a self-regulatory set of guidelines developed by industry.[51] In this regard, Georgeson Shareholder saw room to require that telephone shareholder scripts should include an opt-out question, and should continue to be approved by legal advisers and companies.[52] CDM Telemarketing suggested that the thrust of any proposed legislation should be aimed at telemarketers who are not supervised and do not use legally approved scripts.[53]

5.48 The Minister for Financial Services and Regulation responded to these concerns in his letter to the Chairman of the Committee, received and tabled at public hearings on 25 June 2001. In the letter he announced his intention to move an amendment which would narrow the ambit of telephone monitoring during takeovers to calls to retail shareholders. At hearings on 27 June, the Department of the Treasury confirmed the Minister's intentions.[54] However, the amendments introduced with the Bill, and passed by the House of Representatives on 28 June, did not address the tape recording issue.

Issues relating to Australia as an international financial centre

5.49 The stated aims of the Bill include enhancing Australia's international competitive position and its role as a global financial centre. In this context the Bill implements a major recommendation of the Committee's report on the draft Bill that the shareholder limitation on the Australian Stock Exchange Limited be increased from 5 per cent to 15 per cent. In relation to the present Bill, however, the Committee received evidence that some of its provisions may tend to hinder these aims.

5.50 Morgan Stanley Dean Witter Australia Limited submitted that there were a number of aspects of the Bill which had the potential to impede significantly the ability of substantial foreign groups to continue to provide financial services to Australians. These concerns arose from the broad ambit of the licensing regime and the absence from the Bill of the existing provision under which unlicensed overseas entities may operate through Australian licensees. Morgan Stanley submitted that a provision in the Bill for a licensing exemption for certain services provided only to wholesale clients was important and welcome, but was still defective.[55]

50 Committee Hansard pp. 242–43.

51 Committee Hansard, p. 168, and supplementary Submission no. 24B, p. 2.

52 Committee Hansard, p. 243.

53 Submission no. 20, p. 2.

54 Committee Hansard, p. 271.

55 Submission no. 12, pp. 1–2.

5.51 Morgan Stanley advised that the existing structure was vital for overseas financial service providers accessing the Australian market. The present structure allows the use of the full resources of substantial foreign entities, while also complying with investor protection and market integrity provisions through an Australian licensed dealer. Under the Bill, however, Australian licensed subsidiaries would have to operate on their own account, with extra costs in IT, booking, risk management and other infrastructure. Morgan Stanley put to the Committee that this may not be cost effective, given the size of the Australian market.[56]

5.52 Goldman Sachs Australia Pty Ltd expressed similar concerns about what it sees as the wide scope of the Bill, which it advised, appears to extend to activities which have little connection with Australia. Goldman Sachs accepted that while it may be appropriate, particularly in relation to the Internet, to regulate financial products from overseas which are sold to Australian retail customers, the same considerations may not be present in the wholesale market. Australian wholesale consumers should have access to foreign financial products which can provide wider choice and reduced cost. In a reflection of the Morgan Stanley submission, Goldman Sachs argued that the exemption from the Bill of certain overseas providers of wholesale financial services is insufficient for the practicalities of the market.[57]

5.53 Goldman Sachs advised that omissions in the Bill, together with its broad scope, could result in overseas providers of financial services to Australian customers through Australian licensed service providers coming within the ambit of the Bill. This would require those overseas providers to become licensed, which is not the case under the present law. Consequently, overseas financial markets and products may be less available to Australian wholesale customers. The Bill even appears to require overseas custodial services performed for Australian clients to be licensed, whether or not the assets in question are Australian. The result may be to deter overseas organisations from providing a full range of services to their Australian corporate clients, due to the required restructuring of their business.[58]

5.54 Goldman Sachs concluded that some participants in large international financial centres may cease servicing Australian wholesale investors, because of the additional burden of Australian registration and the related capital and compliance costs associated with what would likely be only a small part of their total business. Goldman Sachs suggested that this would be the opposite effect to one of the expressed purposes of the Bill, which was to increase competition in the supply of financial services.[59]

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56 Submission no. 12, p. 2.

57 Submission no. 33, pp. 1–2.

58 Submission no. 33, p. 2.

59 Submission no. 33, p. 2.

5.55 The concerns of these foreign financial services participants were paralleled by a major domestic participant, the Australian Stock Exchange Limited (ASX). ASX officials told the Committee that difficulties remain in relation to the Bill and Australia's international competitiveness in a technologically innovative, integrated globalised market. The stated aims of the Bill are to provide a flexible and competitive supervisory framework, but the ASX advised that the Bill will not assist its efforts to achieve international linkages which fall short of merger. In particular, the Bill does not easily facilitate links between two exchanges by recognising the validity of foreign regulation and thus obviating the need to simultaneously meet Australian and international regulation. The ASX and other Australian operators will therefore remain subject to barriers to entry in foreign jurisdictions; even if these barriers are overcome the Australian operators will have to comply with both the overseas legislative requirements and the provisions of the Bill. The ASX advised that the result would not be a level playing field.[60]

5.56 In response to questions from Committee members, the ASX officials provided written details of a proposed linkage with its Singapore counterparts, to illustrate deficiencies in both the present legislation and in the Bill. The ASX advised that the duplication of the dealer and market licensing requirements across and within the two jurisdictions would not be resolved by the Bill.[61] The ASX advised that the Bill should instead provide a framework for mutual recognition, to be effected by exemption and modification powers. The ASX told the Committee that the Bill or the Explanatory Memorandum should send a clear policy message about the need to facilitate cross-border linkages.[62]

5.57 The ASX further advised that, under the Bill, clearing houses will have two masters; ASIC, which will address fairness and effectiveness, and the Reserve Bank, which will be concerned with financial stability and systemic risk. The ASX submitted that it is unlikely that these two roles will be neatly compartmentalised, which may impede regulatory processes.[63]

5.58 The Institute of Chartered Accountants of New Zealand (ICANZ) raised similar concerns about their members resident in Australia and about their many members resident in New Zealand who have clients in Australia. The ICANZ questioned whether the Bill paid sufficient attention to individuals who may offer financial advice to Australian residents from outside Australia. The ICANZ suggested that it was unclear whether licensing provisions which were intended to operate beyond national borders were workable or enforceable. The ICANZ submitted that an important priority of the Bill should be to facilitate the international trade in services,

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60 Committee Hansard, pp. 230–31.

61 Submission no. 93, pp. 1–6.

62 Submission no. 93, p. 7.

63 Committee Hansard, pp. 233–34.

by providing for portable cross-national arrangements that minimise compliance costs for those providing the advice and for regulators.[64]

Issues raised by authorised deposit taking institutions (ADI)

5.59 As noted earlier in this report, the final Bill took into account issues raised by the Committee in its report on the draft Bill, especially in relation to the provision of basic deposit products through agencies in rural and regional areas. The Committee, however, received evidence that these changes may not have gone far enough. For instance, the Australian Finance Conference (AFC), whose submission was supported by the Queensland Association of Permanent Building Societies, advised that the Bill still promised costs and problems for ADI in relation to basic deposit products, even though such products are well understood by consumers and there has been no market failure.[65] The AFC accepted that the concessions are a step in the right direction, but advised that there are still fundamental difficulties with the operation of the exemption.[66]

5.60 The AFC advised that one problem area was unnecessary disclosure statements and competency prescriptions for even simple basic deposit products. The result is more paperwork and administrative costs, which are naturally passed on to customers. Additional costs will result from formalised competency standards for staff training, changes in product development and marketing, delays in the introduction of products, changes to existing products and restrictions on product availability.[67]

5.61 The AFC told the Committee that another problem area was the illogical limit of two years for basic deposit products. This concession will cover most deposits at the present time when interest rates are low. The arbitrary and unnecessary nature of the limit will, however, discourage ADI from offering term deposits beyond two years. This will distort the market when in the future interest rates are higher and there will be greater demand for longer term fixed deposits.[68]

5.62 The AFC asserted that the disincentive to offer such products will be greater for agencies, which in remote areas are more usual than branches. The Bill will discourage financial institutions from using agencies, which will reduce deposit choices available to customers in remote areas.[69]

5.63 In summary, the AFC opposed the application of the Bill to what it advised were simple, well known deposits and non-cash payment facilities. The AFC advised that in relation to **all** deposit products:

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64 Submission no. 38.

65 Submission nos 11, 11A and see Submission no. 32.

66 Supplementary Submission no. 11A, pp. 1–4.

67 Supplementary Submission no. 11A, p. 2.

68 Supplementary Submission no. 11A, p. 2.

69 Supplementary Submission no. 11A, p. 3.

i. There is no market failure

ii. There is no shortage of consumer information

iii. The products and services are neither new nor complex

iv. The products are low risk and are not subject to market fluctuations

v. Customers clearly understand the products and services

vi. There is an efficient, competitive informed market for the products

vii. The products are subject to strong prudential supervision through the Australian Prudential Regulatory Authority (APRA)

viii. There is no evidence that the benefits to the public from the proposed changes outweigh the costs to government, business and the consumer.

5.64 The AFC therefore recommended that all simple deposit products and related non-cash payment systems be excluded from the ambit of the Bill.[70]

5.65 Most other submissions from ADI approved exemption of the basic deposit products, but advised that they had reservations about whether the provisions would operate in the manner intended. For instance, the Credit Union Services Corporation (Australia) Limited (CUSCAL) questioned the clarity of the provisions. CUSCAL pointed out that many deposit products offered by credit unions include terms and conditions which require notice before withdrawal of money, or terms which impose conditions upon early withdrawal. Other deposit products such as Christmas club accounts impose time restrictions on withdrawal. Credit unions also offer fixed term deposits which include restrictions on withdrawals. CUSCAL advised that in practice there are no penalties on early withdrawals, because the nominal restrictions are merely an aid to prudent risk management. CUSCAL further advised, however, that it was unclear whether these products came within the relevant provision in the Bill as drafted. CUSCAL suggested a minor drafting amendment which would put the matter beyond doubt.[71]

5.66 The Australian Association of Permanent Building Societies (AAPBS), on the other hand, advised that it was generally satisfied with the provisions relating to basic deposit products and related non-cash payment facilities. The AAPBS told the Committee that the changes will go a long way towards enabling ADI to continue to provide basic deposit products. The AAPBS did not expect a decline in the level of service through agents to rural and regional communities in relation to these products,

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70 Supplementary Submission no. 11A, pp. 3–4.

71 Submission no. 18, pp. 1–3.

but submitted that obviously the same could not be said for agents who supplied other services, who will be subject to the full rigour of the disclosure regime.[72]

Issues which affect small business

Introduction

5.67 In its earlier report on the draft Bill the Committee identified the impact upon small business as a key issue. In particular, the Committee concluded that the disclosure of the quantum of commission on risk insurance products could unfairly affect small business and recommended that this requirement should be deleted from the Bill. As noted earlier, the Government rejected this recommendation. During its inquiry into the present Bill, however, the Committee received evidence from small business representatives that risk commission disclosure was still a major concern.

5.68 The Committee also received evidence of other small business concerns about the effect of the Bill. The Committee expressly records its appreciation for the small business proprietors and organisations which made submissions to the inquiry and who appeared as witnesses. The Committee is grateful for the direct and emphatic nature of the evidence they presented.

Disclosure of quantum of commission on risk products

5.69 The Life Advisers Action Group submitted that provision in the Bill for commission disclosure on risk business in dollar amounts was the worst possible scenario, reflecting insensitive intolerance towards a legitimate grievance. There is no lack of confidence, at point of sale or otherwise, between life adviser and customer. In fact the major concern of customers is the lack of service and inefficiencies of the life offices. The provision in the Bill serves no useful purpose and could be a serious impediment to a legitimate small business marketing process. There are significant differences between investment products and risk insurance products which justify different approaches to commission disclosure. Agents are influenced not by commissions paid, but by business considerations such as good claims departments and competitive premiums. The main customer issue was that commission is payable, rather than the amount of the commission, which is available on request. There are also practical difficulties in relation to quantum commission disclosure. For instance, commission payable varies according to the services performed by the provider, even though the premium is the same. In addition, it may not be possible to quantify the commission at the point of sale.[73]

5.70 The Association of Financial Advisers (AFA) similarly draws a distinction between investment products and risk products, with full commission disclosure appropriate only for investment products. The AFA advised that the customer makes a decision in relation to risk products based on price, not commission. The major

72 Submission no. 8, pp. 1–2.

73 See Submission no. 4, and Committee Hansard, pp. 78–92.

complaint from consumers is not commission, but lack of quick access to information from life companies about products for which the consumer has already paid.[74]

5.71 Mr Max Harris of Max Harris and Associates Pty Ltd, a firm of financial service consultants, submitted that the provision was unworkable, with no tangible benefit for clients. It would also threaten the viability of small business in this area.[75] The Insurance Advisers Association of Australia advised that disclosure of risk commission does not benefit the consumer, who in any event is able to request information about the commission.[76] The National Insurance Brokers Association submitted that there was no necessity to disclose commission details for risk insurance products.[77]

5.72 On the other hand, the Australian Associated Motor Insurers Limited (AAMI) submitted that it supported the commission disclosure provisions in the Bill as drafted.[78] The Financial Planning Association (FPA) advised that it supported universal disclosure and was concerned that disclosure was required only where commission affects the return from a product. The FPA believed that this would compromise the level playing field for all participants.[79] The Insurance Council of Australia advised that, in the spirit of the Bill, commission disclosure was appropriate.[80]

Other issues affecting small business

5.73 The other main issue raised by small business representatives was the possible adverse effect of the Bill on the financial viability and value of their businesses. Mr Michael F. Murphy of Murphy Financial Services (SA) Pty Ltd, who has had wide experience in the area, submitted that the Bill was against the interests of small business. Mr Murphy told the Committee that the Bill was biased in a number of ways in favour of the product manufacturers or their representatives, who represented the big end of town. Mr Murphy advised that this did not help consumers, who could be best assisted by the advocacy of advisers who were in direct contact with them. Mr Murphy submitted that under the Bill compliance costs were so excessive that those consumers who most needed advice would be unable to obtain it, because they would lack the means to pay. Costs were such that Mr Murphy could now generally open files only for clients with substantial assets.[81]

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74 Submission no. 6, pp. 1; 4.

75 Submission no. 23.

76 Submission no. 27, p. 1.

77 Supplementary Submission no. 63A, p. 4.

78 Submission no. 56, p. 1.

79 Submission no. 17, p. 2.

80 Supplementary Submission no. 42A.

81 Submission no. 50, pp.1–5.

5.74 Mr Murphy advised that two areas of particular concern were commission disclosure on risk insurance (which is dealt with elsewhere in this chapter) and changes in the principal and agent relationship affecting the agent's right to work. Mr Murphy suggested that if a licensee failed and an administrator or trustee was appointed, the clients would still be funding accumulation plans and generating commission from that income stream, but that neither of these sources of income would be paid to the adviser. The adviser would have no remuneration until the administration was completed, because the clients remain tied to the licensee. The adviser would therefore be obliged to establish a new client base and build up a new portfolio before receiving worthwhile remuneration from the new business.[82]

5.75 Mr Murphy also advised that there would be problems if a licensee suspended or cancelled the proper authority of an adviser for reasons other than fraud or criminal behaviour. Mr Murphy told the Committee that the adviser would be unable to give advice to clients, who may be unaware of the new legal position. Mr Murphy advised that the Bill should provide that in such cases the adviser may transfer the clients, together with their business and income stream, to another licensee without prejudice.[83]

5.76 The Life Advisers Action Group advised that it had reservations about aspects of the Bill affecting small business. The Bill does not appreciate that most financial advisers are small businesses, which employ staff, not sole proprietors.[84] The Association of Financial Advisers (AFA) noted in particular that the Bill changed the present relationship between agents and principals, which affected the financial adviser's right to work.[85]

5.77 The AFA had other concerns similar to those of Mr Murphy. In particular, that the Bill should be amended to provide that, if a licensee is suspended or banned, the individual proper authority will continue to be valid, thus enabling the financial adviser to continue to operate the business as usual. The Bill should also provide for all money owing to the financial adviser from continuing business activity, including continuing commissions, to be paid as in the normal course of business.[86]

5.78 The AFA, again like Mr Murphy, was also concerned that under the Bill a licensee may revoke a proper authority without good reason and without compensation, which is a change from the present position. The Bill makes no provision for compensation for such revocation or for payment of continuing commissions from the adviser's clients. The AFA submitted that this would reduce the market value of agency businesses. The AFA advised that the Bill should provide that

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82 Submission no. 50, pp. 6–7.

83 Submission no. 50, pp. 6–7.

84 Committee Hansard, p. 90.

85 Submission no. 6, pp. 2–3.

86 Submission no. 6, p. 3.

an authority may be revoked only for fraud or criminal conduct, pending negotiated resolution of difficulties with natural justice for the financial adviser.[87]

5.79 Mr Lee Carter of Arlington House Pty Ltd submitted that the educational requirements which the Bill provides for licensees may operate harshly in their effect on small business. Mr Carter advised that substantial qualifications at university level and in some cases decades of experience, are disregarded unless the qualifications were obtained comparatively recently. This was the case even if the person in question had maintained membership of professional associations and regularly attended training sessions. Small business proprietors are busy all the time and the changes made by the Bill will increase the workload of financial advisers. The additional educational qualifications could drive small employers out of business, especially given the short deadline for training.[88] Mr Joseph Nowak of the AFA expressed similar concerns.[89]

5.80 Mr John Campbell of One Stop Financial Services advised the Committee that he had concerns about the effect of the Bill on small business. Mr Campbell stated that as a small business operator he was working to build an asset which had a saleable value. The Bill, however, appears to reduce small business proprietors to the status of employees, but to leave the proprietor with all of the costs and liabilities associated with small business. Mr Campbell submitted that these adverse changes made by the Bill will reduce the market value of small businesses.[90]

5.81 Mr Brett Walker of FSI Consulting Pty Ltd submitted that the prohibition in the Bill on the use of terms such as ‘independent’ and ‘unbiased’ to describe a business which received commission would have an adverse effect on small financial advisers. Mr Walker advised that the realities of small business were that the mere receipt of a commission has never been the measure of independence. The real independence of small business is its ability to operate separately from the influence of large institutional players such as banks and insurance companies. Mr Walker submitted that the Bill should be amended to enable small players to retain such expressions, which are one of their major defences against institutional competitors. The various small business representatives also submitted that disclosure of the quantum of commission on risk products would drive down commissions, to the benefit of the large product providers and to the detriment of the smaller operators. This would affect adversely the viability and value of this business.[91]

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87 Submission no. 6, pp. 3–4.

88 Submission no. 57.

89 Committee Hansard, p. 111.

90 Submission no. 55.

91 Submission no. 13, pp. 1–2.

Issues relating to the insurance industry

Introduction

5.82 The submissions identified a number of issues of concern to insurance providers, the most important of which are set out below.

Cooling off period

5.83 The Bill provides for a general cooling off period of 14 days within which a financial product may be returned. However, a number of submissions from insurance companies and others, advised of problems in relation to the provision. The Insurance Council of Australia (ICA) noted that renewal invitations are sent to retail clients some weeks before the actual anniversary date, usually much earlier than 14 days. The effect of the Bill, however, is that the cooling off period will start from the date of renewal or the anniversary, which the ICA advised was an unnecessary and impractical level of consumer protection. The ICA therefore recommended that the cooling off period should not apply to renewals.[92] The Australian Associated Motor Insurers Limited (AAMI) advised that a cooling off period was appropriate for new insurance business but was excessive for renewals for which notice is given at least 14 days before the due date.[93] The BT Financial Group similarly advised that the cooling off period should apply only to the initial issue of a product, not to top-up an existing holding.[94] The International Banks and Securities Association of Australia advised that in relation to the cooling off period for managed funds it was important that the foreshadowed regulations in the Bill should provide for adjustments to amounts repaid for market linked products.[95]

Compulsory third party (CTP) and workers' compensation insurance

5.84 A number of submissions advised that these classes of statutory insurance were provided in some States and Territories by private companies and in others by government entities, with undesirable consequences for the operation of the Bill.

5.85 The NRMA Insurance Group recommended that statutory workers' compensation and CTP insurance be excluded from the definition of financial product in the Bill. The NRMA pointed out that workers' compensation issued in some states will not come within the Bill because it is state underwritten, whereas similar insurance in other jurisdictions which is not underwritten by the state will be caught by the legislation. Furthermore, following review by the National Competition Council the status of these schemes could change on a case by case basis, adding to the complexity of the regime. If the Bill retains these clauses of insurance there will be

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92 Submission no. 42, pp. 13–14.

93 Submission no. 56, p. 6.

94 Submission no. 45, p. 2.

95 Submission no. 60, p. 2.

a double layer of compliance regulation, which would negate the benefits of a single, uniform regulatory regime.[96]

5.86 The Insurance Council of Australia (ICA) expressed similar views, advising that inclusion of workers' compensation and CTP insurance at this stage would simply add more regulation and potential jurisdictional conflict to the already complex regulation imposed at State and Territory level.[97] The AMP Limited advised that the exclusion from the Bill of some products in these classes of insurance but not others was a fragmented and illogical approach.[98] The Australian Associated Motor Insurer Limited (AAMI) submitted that including CTP insurance in the Bill will make regulation more onerous and increase potential regulatory conflict.[99]

5.87 Organisations which made submissions emphasised generally that including workers' compensation and CTP insurance in the Bill would increase compliance costs. The Chartered Secretaries Australia advised that there was a potential for different cost structures, with States with private insurers having higher costs because of the requirements of the Bill.[100] The AAMI and ICA warned of increased costs, which the NRMA advised would be passed on to the consumer.[101]

5.88 The submissions on this general point recommended that these statutory insurance classes should be brought under the Bill only if they were included in a uniform national scheme. There was broad agreement that regulatory uniformity for these classes was desirable, with statutory insurance expressly excluded from the Bill until this could be achieved. The submissions agreed that the Commonwealth in conjunction with the States should commit resources to achieve a single national regulatory framework for CTP and workers' compensation insurance.

Insurance quotes by telephone

5.89 Some submissions advised that the Bill imposed unreasonable restrictions on the provision by telephone of quotes for insurance cover. The NRMA Insurance Group submitted that the requirement in the Bill to provide an oral Financial Services Guide (FSG) to all telephone callers was a significant problem for insurers such as NRMA with a large telephone contact business. In this context NRMA received 100 000 telephone inquiries each week. All inquirers who eventually become customers receive full disclosure documentation and have the benefit of the cooling off period, so the prior oral FSG is unnecessary and costly duplication. Also the requirement did not comply with the competitively neutral intention of the Bill, because financial service providers not significantly dependent upon telephone sales

96 Submission no. 25, p. 3.

97 Submission no. 42, pp. 5–6.

98 Submission no. 49, p. 5.

99 Submission no. 56, p. 4.

100 Submission no. 65, p. 5.

101 Submission nos 56, p. 4; 42, p. 5; 25, p. 3.

would have an advantage over others for which this is a major distribution channel. The NRMA therefore recommended that the requirement be removed.[102]

5.90 The Insurance Council of Australia (ICA) also warned that the requirement to provide extensive disclosure information by telephone would increase costs and call times for consumers. The ICA submitted that this would far outweigh any intended consumer benefit, given that the major insurers collectively handle more than 200 000 calls each week. The requirement could overwhelm call centres and put pressure on rural branches and branch agencies. The ICA recommended that extensive oral disclosure should not be required for general insurance transactions by telephone. The AMP Limited endorsed the ICA submission, advising that the requirement would increase costs by 5–8 per cent for each individual policy.[103] The National Insurance Brokers Association also submitted that the provision of a quotation alone for a general insurance product should not be regarded as a financial service. However, if the consumer accepts the quote then the general provisions of the Bill should apply.[104]

Travel insurance

5.91 The Committee received a number of submissions which advised that the Bill would have adverse consequences in relation to the provision of travel insurance. QBE Insurance (Australia) Limited, American Home Assurance Company and Transport Industries Insurance (QBE) submitted that the Bill would have adverse effects on consumers, travel agents and the relevant insurers. QBE advised that aspects of the regime were not appropriate for the sale of simple general insurance risk products such as travel insurance, which are inherently different from investment type products. Unfortunately, however, much of the Bill is based on existing regimes for these investment products. In the absence of suitable recognition of simple risk products the Bill will result in a breakdown of the present distribution structure for those products, with more consumers travelling uninsured or underinsured. In some instances, consumers may look overseas for their travel insurance.[105]

5.92 QBE submitted that to avoid these consequences the Bill should be amended and administrative action taken. For instance, there should be some exemption from the training requirements for representatives in relation to a single retail product class such as travel insurance. Also sub-authorisations should be permitted by all authorised representatives, to enable small businesses and partnerships to sub-authorise their employees and agents. In addition, there should be changes to the requirement for a licensee to notify ASIC within 10 working days of all authorised representatives, which provides no protection for consumers of simple retail products. There should also be appropriate exemptions for products sold over the telephone and for disclosure in relation to the sale of travel insurance by travel agents or airline booking staff.

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102 Submission no. 25, p. 2.

103 Submission no. 42, pp. 14–15.

104 Supplementary Submission no. 63A, p. 3.

105 Submission no. 52, pp. 1–2.

Finally, the 14 day cooling off period should be modified to avoid the situation where an insured returns from a holiday within the 14 day period and seeks to exercise the right to return the product.[106] In this context, the Insurance Council of Australia recommended that the cooling off period for short-term contracts should end on the day before the contract begins.[107]

5.93 The Australian Federation of Travel Agents (AFTA) advised that it had worked closely with the companies which had made the QBE submission. AFTA was deeply concerned with impositions which the Bill makes on travel agents, which will inevitably be passed on to the consumer.[108] Thomas Cook Travel (Australia) Pty Ltd submitted that travel insurance sales represent a significant proportion of travel agents' revenue and any reduction of that revenue could adversely affect employment.[109]

5.94 The Australian Travel Agents Cooperative (ATAC) advised that the Bill in its present form makes unacceptable demands on travel agents. The ATAC expressed total support for the QBE submission.[110]

Prohibition on hawking

5.95 The Australian Associated Motor Insurers Ltd (AAMI) and the Combined Insurance Company (CIC) separately raised concerns about the provision in the Bill which prohibits the hawking of financial products. The AAMI advised that it is usual general insurance industry practice to telephone insureds to advise them of other products and to ensure that they are fully covered in the case of loss.[111] The CIC stated that the terms of the prohibition would result in uncertainty and effectively deny access to financial products by substantial categories of consumers. In particular, it would continue the trend for financial service providers to lessen personal contact with consumers in rural areas. The CIC advised that it was appropriate to prohibit the hawking of securities, but not general insurance products. The CIC noted that the general insurance industry was already heavily regulated by Federal and State consumer protection laws, which addressed adequately the type of practice at which the provision in the Bill was apparently directed.[112] Both AAMI and CIC recommended that the prohibition effectively not apply to the general insurance industry.[113] The Insurance Council of Australia endorsed the CIC submission.[114]

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106 Submission no. 52, pp. 4–5.

107 Supplementary Submission no. 42A.

108 Submission no. 66.

109 Submission no. 88.

110 Submission no. 64.

111 Submission no. 56, p. 4.

112 Submission no. 94, pp. 3–5.

113 Submission nos 56, p. 4; 94, p. 11.

Issues relating to declared professional bodies

Introduction

5.96 In its report on the draft Bill the Committee concluded that concerns expressed in relation to the declared professional bodies provisions were valid. The Government response to the report did not accept this position, although the final Bill includes some amendment of relevant definitions. However, during the present inquiry the Committee received evidence that concerns remain in this area, in regard to both the operation of the provisions and their conceptual framework.

Operation of the declared professional body provisions

5.97 Submissions from professional bodies advised that there would be problems with the operation of the provisions. The Law Institute of Victoria noted that a solicitor acting in a professional capacity has certain well recognised obligations towards clients. The primary obligation is to advise clients on matters of law, but obligations extend beyond legal matters to include all matters which are within the terms of the retainer as well as all incidental or related matters. These obligations may be quite different. It is not open to a solicitor engaged to advise on all aspects of a matter in a professional capacity, to limit advice to matters of a legal nature. Indeed, a professional adviser may be liable for failing to give financial advice outside the terms of the retainer. There is, however, a well known line between a solicitor's professional advice and activities which are entrepreneurial with the two being mutually exclusive.[115]

5.98 The Law Institute of Victoria concluded that there was a clear dividing line between advice provided incidentally as part of a solicitor's professional practice and advice offered in the course of a solicitor's non-legal business activities. The exemption provided in the Bill for incidental advice was, however, too narrow. As presently drafted the Bill will require solicitors to be licensed to provide advice in the normal course of their practice.[116]

5.99 The Law Council of Australia expressly endorsed the submission from the Law Institute of Victoria.[117] In addition, the Law Council of Australia advised that the basic principle for consideration of the Bill should be that it is intended to regulate participants who are centrally involved in the financial services industry. The Bill should not regulate those on the periphery of that industry who may have some influence over another person's dealings with the issuer of a financial product. The Bill, therefore, should not regulate lawyers who provide traditional legal services, but should include within its ambit lawyers who hold themselves out as core players in the

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114 Supplementary Submission no. 42A.

115 Supplementary Submission no. 7A, pp. 2–4.

116 Supplementary Submission no. 7A, p. 5.

117 Supplementary Submission no. 21A.

financial services industry, such as promoters of mortgage loan schemes.[118] The Law Council of Australia gave instances where, as part of a commercial lawyer's day to day practice, advice is given which is more than legal advice. The Bill in these instances would require the lawyer to be licensed. The Law Council of Australia submitted that public policy did not require further regulation of lawyers, who were already subject to comprehensive supervision. Instead, the Bill should be amended to provide an exemption for all incidental advice provided by lawyers, instead of the narrow and restricted proposed exemption. The existing exemption for lawyers in the Corporations Law/Corporations Act is satisfactory and should be continued.[119]

5.100 A submission from eight of the largest commercial law firms made similar points, advising that they had grave concerns about the application of the Bill to the provision of ordinary commercial legal advice.[120] The submission advised that the Bill should be amended to exempt from its operation advice which is part of ordinary professional practice, including advice which is incidental to this. There is a clear line between such advice and other activities such as, for instance, promoting mortgage or other investment schemes, which should be subject to the Bill. The present exemption for incidental legal advice in the Bill is very restrictive and therefore can be remedied only by amendment and not, for instance, by ASIC interpretation.[121]

5.101 The commercial law firms also submitted that it is impossible for lawyers who are advising clients about commercial transactions to avoid giving commercial advice and that it would be bad public policy if the Bill discouraged lawyers from doing this. The Bill adds another compliance layer for lawyers without measurable benefits. It is plainly false that the claimed regulatory neutrality will be achieved by including incidental advice by lawyers within the scope of the Bill. Any benefits of the Bill for clients would not equal the detriments of increased compliance costs and intrusion into the relationship between lawyer and client.[122]

The conceptual framework of the declared professional body provisions

5.102 The legal professional bodies expressed reservations about not only the operation of the relevant provisions, but also their conceptual framework. The Commercial Law Section of the Financial Services Committee of the Law Institute of Victoria submitted that, despite presumed safeguards for solicitors giving incidental financial advice, the Bill was an unwarranted intrusion into the independence of the legal profession. The requirement that solicitors must limit their advice according to conditions imposed by ASIC would severely restrict the independence of the profession and impede the giving of independent impartial advice to clients.

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118 Supplementary Submission no. 21B, pp. 1–2.

119 Supplementary Submission no. 21B, pp. 3–4.

120 See Appendix 1, Submission no. 87 for the names of these firms.

121 Submission no. 87, p. 2.

122 Submission no. 87, pp. 2–5.

5.103 The Law Council of Australia advised that it seriously questioned whether ASIC should divert from its core regulatory function to assume additional functions which would essentially amount to the regulation of the legal profession. It is likely that the various law societies may not seek to become declared professional bodies, given the uncertain and potentially onerous obligations which will be imposed upon them. This would effectively result in the legal profession being directly regulated by ASIC.[123]

5.104 The submission from the commercial law firms made the same point, requesting an amendment to the Bill to ensure that neither lawyers nor law societies are subject to ASIC regulatory supervision in relation to ordinary professional practice by solicitors, including advice which is incidental to that practice. There is no assurance that state-based law societies will be willing to become declared professional bodies, with the result that most law firms may need to be licensed. ASIC will therefore be required to oversight lawyers.[124]

5.105 The commercial law firms further submitted that it was not appropriate for ASIC to have regulatory oversight of solicitors in the ordinary practice of their profession, even if that practice includes giving incidental financial advice. ASIC supervision could indirectly compromise fundamental rights such as a client's right to legal professional privilege. Supervision of this nature is an intrusion by government into the relationship between lawyer and client for which there is no justification. Traditionally, communication between lawyers and clients has been protected from discovery by government agencies out of concern that this would deter clients from providing information necessary for them to receive full legal advice. The Bill, however, may overturn this protection by the powers which it gives to ASIC. Under the Bill ASIC may demand information from lawyers even where ASIC has no reason to believe that a law has been breached and where its access is purely random. The commercial law firms submitted that it was bad policy to override such a fundamental right in relation to provisions intended to protect those same consumers.[125]

Professional bodies representing accountants

5.106 Other professional bodies apart from those representing lawyers supported the general position of the legal professional bodies.

5.107 CPA Australia and the Institute of Chartered Accountants in Australia (ICAA) jointly submitted that they were particularly concerned that their members who offer traditional accounting services may inadvertently be caught by the Bill. In this context they advised that the Bill should be specific about who is required to be licensed. CPA Australia and ICAA supported the declared professional bodies provisions, but not as

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123 Submission no. 7.

124 Submission no. 87, p. 1.

125 Submission no. 87, pp. 3–4.

a general provision to cover any ambiguity in who should be licensed. Traditional accounting and tax advisory services should be excluded from the Bill.[126]

5.108 The National Institute of Accountants (NIA) advised that the Bill blurred the distinction between the purpose of a professional body and that of a regulator. For instance, it is not the role of a professional body to implement government policies or to be a spokesperson for the government on the regulator. There is also a disparity in that the resources and staff available to professional bodies are not equal to those of regulators. The NIA suggested that there is some consternation over the degree of supervision of members which professional bodies are expected to exercise.[127]

Consumer protection issues

Introduction

5.109 The Government has stated that the changes introduced by the Bill will deliver considerable benefit to consumers.[128] Nevertheless, while a principal object of the single licensing and disclosure regimes has been to simplify and make more transparent the activities of financial service providers, some aspects of the legislation have been criticised as having potentially negative implications for consumers.

5.110 Consumer organisations identified a range of technical or operational difficulties arising from the Bill. Concerns were expressed about the effects of exemptions from disclosure or licensing requirements which may allow training standards or the quality of advice to be reduced under the Bill. In particular, consumer organisations questioned exemptions for bank clerical staff and rejected proposals that risk insurance products should be exempted from commission disclosure requirements. The Committee also heard that controls on pressure selling under the Bill were not wide reaching enough to protect consumers.

5.111 Doubts also arose about the effectiveness of the conceptual framework proposed for professional bodies, in which both exemptions from licensing requirements and obligations as industry regulators would apply. At hearings the operation of dispute mechanisms was a focus of concern with the independence of the external dispute schemes, such as the Financial Industry Complaints Service (FICS), being questioned. Finally, the Committee was advised by representatives of ethical investment groups about growing consumer interest in socially responsible investment (SRI) products.

5.112 Since the submissions were received, some of the consumer issues raised have been addressed or partially addressed by the Financial Services Reform (Consequential Amendments) Bill 2001 or by the Government's amendments to the

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126 Submission no. 40, p. 1.

127 Submission no. 48, *passim*.

128 'Hockey Introduces Financial Services Reform Bill', Minister for Financial Services and Regulation, *Press Release* no.SR/025, 5 April 2001.

Financial Services Reform Bill 2001, introduced in the House of Representatives on 7 June and 28 June respectively. Two such matters related to the Bill's failure to update mirror provisions under the ASIC Act to reflect those in the Trade Practices Act, and the removal of fairness obligations which stood in the Corporations Law and in the draft exposure Bill.

ASIC Act/Trade Practices Act mirror provisions

5.113 In its submission, the Financial Services Consumer Policy Centre expressed the view that the Bill should include provisions updating the ASIC Act, so to more accurately reflect amendments to the Trade Practices Act. The FSCPC reminded the Committee that mirror provisions in the Trade Practices Act (as amended in 1998 and 2000) and those in section 12 of the ASIC Act had been inserted when financial services were removed from the Australian Competition and Consumer Commission's consumer protection jurisdiction. At that time, the Government had pledged that ASIC's powers would keep pace with those in the Trade Practices Act.[129]

5.114 The FSCPC advised that this has not happened, resulting in the following inconsistencies:

- the TPA now protects small business from unconscionable conduct, while the ASIC Act is limited to personal clients (1998 amendments);
- maximum penalties under the TPA were increased from $44 000 to $220 000 for individuals and from $220 000 to $1.1 million for corporations while the penalties under ASIC Act remain unchanged;
- the ACCC has been empowered to intervene in private litigation while ASIC has not (2000 amendments); and
- the TPA now has a uniform limitation period of six years while the ASIC Act still contains a mixture of two and three year limitation periods.[130]

5.115 The FSCPC concluded that this is unacceptable, and creates a situation where small business is subject to maximum penalties five times greater than those faced by a large corporation, such as a bank.[131]

5.116 At hearings in Sydney on the 13 June, the Director of the FSCPC, Mr Chris Connolly, was pleased to advise that the Centre's concerns had been addressed by the Financial Services Reform (Consequential Provisions) Bill 2001.[132] The Bill ensures

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129 Submission no. 37, pp. 2–3.

130 Submission no. 37, p. 2.

131 Submission no. 37, p. 3.

132 Committee Hansard, p. 55.

that ASIC will now have the same powers, penalties and limitations available to it as the ACCC.[133]

Removal of the obligation to act 'fairly'

5.117 Consumer organisations alerted the Committee to a possible weakening of the obligation to act with integrity in the marketplace as a result of the present drafting of the Bill. The Australian Consumer's Association (ACA) and the Consumer Credit Legal Service noted that where the Corporations Law and the draft FSR Bill required providers to act 'efficiently, fairly and honestly', the Bill now asks that providers only act 'competently and honestly' and 'to the extent that it is reasonably practical to do so'.[134]

5.118 At hearings in Sydney on 13 June, the FSCPC's Mr Connolly told the Committee that the removal of the obligation to act fairly, with the qualification to meet the new requirement as far as 'is reasonably practical to do so', will make it difficult for consumers to prove a case of misconduct in court. He noted that the fairness requirement has been used successfully in previous court cases to argue that there is a requirement for advisers to act ethically, and that there seems to be no obvious reason for withdrawing the obligation to fairness. Ms Louise Petschler, Senior Policy Officer of the ACA, also told the Committee that the meaning of 'reasonably practical' was quite unclear and that a number of major law firms were concerned about its potential application.[135]

5.119 In a letter to the Chairman of the Committee on the 25 June 2001, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, announced the reinstatement of the obligation to act fairly into the legislation in amendments to the FSR Bill.[136] At hearings on 27 June in Canberra, Ms Vroombout of the Department of the Treasury reported that the Minister had determined to return to the position in the current Corporations Law, following representations that there was a body of case law relying on the obligation to act fairly.[137]

5.120 The amendments were introduced into the House of Representatives on 18 June 2001, and were passed in the House with the FSR legislation on 28 June 2001. The amendments did not, however, withdraw or clarify what might be considered 'reasonably practical' in meeting the obligation.

5.121 In explanation of the qualification at hearings on 27 June, the Department of the Treasury's Ms Vroombout stated that it may not be possible (or practical) to act

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133 See Financial Services Reform (Consequential Provisions) Bill 2001, Explanatory Memorandum, House of Representatives, the Parliament of the Commonwealth of Australia.

134 Submission no. 44, p. 4, and Submission no. 41, pp. 1-2.

135 Committee Hansard, p. 63.

136 The letter was tabled at a public hearing in Canberra on the same day.

137 Committee Hansard, p. 270.

'efficiently, honestly and fairly' in equal measure, in that, for example, something that is very efficient might not be very fair. She advised that the legislation therefore required that a 'balance of all three' attributes should be achieved, and not just any one or two. [138] ASIC also confirmed that the requirement for meeting all criteria had a long history in the securities regime but suggested that any qualification of the requirements by notions of what was 'practical' had to be considered a policy interpretation to be explained by Treasury.[139]

Basic deposit products

5.122 The ACA submitted to the Committee that the Bill created a lower standard of disclosure in retail banking, an area where consumers report difficulty in comparing and understanding products. The ACA also advised that this was an area where consumers often find themselves in accounts which are expensive and difficult to understand, against alternatives that might better suit their needs.

5.123 The ACA was also concerned that training and competency requirements for staff providing basic deposit products was unclear, and the extent of consumer redress difficult to ascertain. The ACA recommended to the Committee that the Bill and the regulations clearly establish that training and competency standards to be applied to staff dealing in basic deposit products must be sufficient to ensure consumers are directed to the appropriate accounts, that all conditions and fees are adequately explained and that areas where further advice should be sought from representatives are clearly understood. The ACA also recommended that breaches such as consumers being directed to inappropriate accounts where lower cost alternatives exist, receiving inadequate explanations of conditions and charges, and receiving inappropriate recommendations on rollover, must be subject to compensation for the consumer.

Exemptions for bank 'clerks and cashiers'

5.124 Consumer groups also argue that industry standards will be lowered, rather than improved, if training or advice requirements are made flexible for particular individuals or industry groups, especially given the emphasis in the legislation on self-regulation and sectoral standard setting.

5.125 At hearings in Sydney on 13 June, Ms Petschler of the ACA told the Committee that the standard of training and competency in the financial services industry is 'one of the most contentious issues' in debate about the consequences of the FSR Bill. In particular, concerns have focussed on exemptions for 'clerks and cashiers' providing advice on basic deposit products.[140] These exemptions hinge on the definition of personal advice, with those employees who do not actually offer

138 Committee Hansard, p. 295.

139 Committee Hansard, pp. 354–55.

140 Committee Hansard, p. 58.

advice about financial products being exempt from meeting competency levels required for financial advisers under the Bill.

5.126 In the Committee's report on the draft Financial Services Reform Bill, exemptions for clerks and cashiers in the banking industry were recommended on the basis that counter staff carry out routine tasks such as taking deposits, so should not need to be qualified. The recommendations aimed at relieving concerns that the legislation would put undue pressure on rural and regional financial service providers, given that some operate through such outlets as pharmacies and newsagents.[141] Amendments were included in the present Bill and welcomed by the Australian Association of Permanent Building Societies, for example, which judged that the changes would sustain the present level of services in non-metropolitan areas.[142]

5.127 However, at hearings, the ACA warned the Committee that the exemptions would potentially lower the level of competency that the ASIC Interim Policy Statement 146 (IPS 146) *Training of Authorised Representatives* aims to maintain in the banking industry. Ms Petschler noted that the statement provides for a two-tier level of training; with a lesser training requirement for providers of general advice, as against personal advice, which nevertheless ensures adequate competency for the type of direction being given to consumers. She advised that the ACA wished to send a strong message that, for the FSR Bill to be successful, 'we cannot afford to exempt these large classes of direct sales and face-to-face contact that consumers have in financial services'.[143]

5.128 The ACA therefore opposed the introduction of exemptions for cashiers and clerks as being contrary to the spirit and objectives of the Bill.[144] The Consumer Credit Legal Centre (NSW) Inc. supported this view, noting that there is currently a paucity of information about suitable banking options for consumers. The Service concluded that: 'Any blanket exclusion of work ordinarily done by clerks and cashiers creates a serious inroad into the proposed consumer protection regime'.[145]

5.129 At hearings on 27 June, the Committee sought to establish the Department of the Treasury's intentions in regard to this aspect of the legislation, and also to ascertain ASIC's views on its interpretation of the provisions related to basic banking products. Both organisations emphasised that the exemption was intended only for those conducting clerical activities such as 'taking money and issuing receipts'.[146] ASIC advised that as soon as any degree of judgement was exercised then this had to be considered as giving advice and staff had to be appropriately authorised and

141 Report on the Draft Financial Services Reform Bill, August 2000, pp. 15–17.

142 Submission no. 8.

143 Committee Hansard, p. 58.

144 Committee Hansard, p. 58.

145 Submission no. 72, p. 2.

146 Committee Hansard, p. 307.

trained.[147] Ms Vamos told the Committee that competency at Training Tier 2, the lesser training level under IPS 146, would be required of all tellers having the responsibility for giving advice.[148]

5.130 ASIC also advised that the Bill distinguishes between this situation and one in which the teller acts as a 'mere conduit': where product information is given on the request of a customer and, perhaps, the client is referred on for advice.[149] This would apply in the case of two-year term deposits where disclosure, rather than training and authorisation, requirements would operate.[150]

5.131 The Department of the Treasury only partly concurred with this, noting that in these circumstances, disclosure requirements would operate in addition to those for training, with authorisation requirements being exempt.[151] Treasury's representative also conceded that tellers dealing with bank deposit products may be under pressure to sell other products and so, to that extent, the full picture in relation to banking products may not be revealed to the consumer.[152]

Exemptions for 'acting outside authority'

5.132 At Sydney hearings on 13 June, the Australian Consumer Association and the Financial Services Consumer Policy Centre also identified problems arising for consumers under the provisions of the Bill which would exempt licensees from liability if their representative discloses that they are 'acting outside authority' when advising clients.

5.133 In its submission, the FSCPC reported that it is the experience of the consumer movement that such an exemption will function as a 'loophole' leading to deliberate abuse of the consumer. The submission cited the case of the 'pay day lending' industry which sprung up to exploit a small provision in the Uniform Credit Code which exempts short term lending.[153]

5.134 Representatives of the ACA also expressed concerns that the exemption would allow salespeople to promote products as special opportunities, while exempting themselves from responsibility by announcing they are 'acting outside of authority'. Ms Petschler saw that a consumer, unaware of the function of the exemption, may imagine that the liability for advice would be carried by the licensee—a life office or whomever the agent represents.[154] The Consumer Credit

147 Committee Hansard, p. 346.

148 Committee Hansard, p. 348.

149 Committee Hansard, pp. 351–52.

150 Committee Hansard, p. 346.

151 Committee Hansard, p. 304.

152 Committee Hansard, p. 306.

153 Submission no. 37, p. 5.

154 Committee Hansard, p. 57.

Legal Service, in its submission, also judged that consumers are unlikely to recognise the full implications of the exemption and so advised that it is 'vital for consumer protection that consumers have redress to a licensee for the actions of a representative'.[155]

5.135 Given this, consumer organisations were opposed to the provision. They recommended that either the exemption should be removed or that the legislation should state clearly that it applies only where a financial services product is not being discussed or provided.[156] The ACA's Ms Petschler also advised that, if the exemption is to apply, then ASIC should provide clear direction on disclosure, and that this should require that the parts of a product being offered that are not within the authority of the agent should be clearly identified.[157]

5.136 Asked to explain the rationale of the exemption at hearings in Canberra on 27 June, the Department of the Treasury's Ms Vroombout advised that the current legislation intends to encourage licensees to cross-endorse people, by having the authorised representatives—the multi-agents—rather than the licensees, carry liability for any misconduct. She also informed the Committee that the decision to have the legislation drafted this way, rather than attributing liability to all licensees represented, was ultimately 'a question of policy'.[158]

5.137 Seeking to clarify the implications for consumers, the Committee later asked ASIC what role a licensee might play in monitoring whether a representative was acting within authority. ASIC representatives emphasised that a 'key licensee obligation' under the legislation is to supervise and monitor their representatives, and this would include ensuring that they act within authority.[159] However, ASIC confirmed that, under the exemption, if an authorised representative declares he or she is acting outside authority, then only the representative is liable for any bad advice given, whether or not the representative is acting for one or more licensee. That is, the requirement to prove liability of a particular licensee in this situation is no longer relevant, as all are exempted from responsibility.[160]

Exemptions for 'declared professional bodies'

5.138 Under the new regime, professional bodies may apply for a declaration which will exempt their members from the requirement to obtain a financial services licence, providing they are not actually dealing in a financial product. This means that they will also be exempt from training requirements for licensees as their professional

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155 Submission no. 41, p. 2.

156 The Consumer Credit Legal Centre Submission no. 41, p. 2 recommended removal, while the FSPC Submission no. 37, p. 5 and ACA Submission no. 44, pp. 10–11 recommended removal or clarification.

157 Committee Hansard, p. 58.

158 Committee Hansard, pp. 296–97.

159 Committee Hansard, pp. 339.

160 Committee Hansard, pp. 339–40.

status deems them equivalently qualified to offer 'traditional' services, such as providing legal advice or accounting services. The qualification of 'incidental advice' will also allow them to give related information, such as commercial judgments, if this is provided in appropriately open ended fashion (ie specific products are not suggested).

5.139 The proposed exemption for declared professional bodies, such as lawyers and accountants, remains contentious for both industry and consumer groups. While many professional bodies strongly supported exemptions for incidental advice and asked for its extension to cover a broader class of financial advice, others saw problems arising from the present drafting of the legislation, with some questioning its workability. Still others were uncomfortable about ASIC's role in interpreting the exemption and asked for certainty about the application of the exemption in the legislation.

5.140 Recognising a potential for confusion and inconsistency, the Association of Superannuation Funds of Australia (ASFA) submitted that exemptions for 'declared professional bodies', runs counter to the objectives of the Bill which require that the same competency standards should be applied for all providers of financial advice.[161] The ACA supported this view, noting that the exemption had the potential to weaken the consumer protection framework intended by the single licensing regime. The ACA also questioned the assumption that professional codes of practice will be adequate to comply with the new regime's licensing requirements.[162]

Obligations of professional bodies

5.141 A related issue raised by the ACA submission was that the exemption for declared professional bodies was at cross-purposes with the expectation that the same professional bodies will be required to oversee the compliance of their members. The ACA saw dangers arising from self-regulation in this instance, citing the example of the solicitors mortgage schemes, where consumers had relied on professional bodies to adequately regulate member activities, with major problems resulting.[163]

5.142 While the Australian Financial Markets Association and the Securities and Derivatives Industry Association, in its joint submission, welcomed the opportunity to self-regulate, and to do so in partnership with ASIC, many in the industry were also uncomfortable about the new requirements. The National Institute of Accountants, for example, wrote that the legislation mistakes the role of professional bodies. The NIA pointed out that professional bodies are ill-fitted to act as regulators, and do not have

161 Submission no. 16, p. 18.

162 Submission no. 44, p. 12.

163 Submission no. 44, p. 12.

access to the information required by ASIC to monitor compliance, nor the resources to set up mechanisms for that purpose.[164]

5.143 In its submission the ACA agreed, noting that the exemption raises concerns about administration and enforcement:

> ACA has little confidence that professional bodies will be able to apply adequate monitoring, compliance and enforcement regimes for members, provide appropriate redress to consumers, or to report systemic or individual breaches of the legislation. While the revised Bill improves on the original exemption in the Exposure Bill (for example, in relation to ASIC monitoring powers, and incidental advice), it does not adequately address these consumer protection concerns.[165]

5.144 The NIA also judged that the role of regulator does not fit comfortably with that of industry representative: where the body looks after the interests of its members and represents their views to government and others.[166] At hearings on 13 June 2001, the ACA also alerted the Committee to this potential conflict of interest, and considered that, from a consumer point of view, it would be preferable to have ASIC as the regulator rather than give professional organisations this responsibility.[167]

5.145 To improve consumer protection under the exemption, the ACA and ASFA recommended that the law should require that the competency levels of any exempted body giving personal advice should be no lower than that demanded by the licensing regime.[168] The ACA also suggested that ASIC's power to approve declarations should be contingent upon a professional body providing evidence that it had the capacity to meet the training and competency standards of the FRS reform in full.[169] ASFA also recommended that, before granting professional body status, ASIC should consult with stakeholders who are likely to be affected by the actions of that professional body.[170]

5.146 The ACA also expressed doubts that the present drafting of the legislation awards ASIC sufficient power to withdraw an exemption from a professional body once it has been given. It therefore recommended boosting ASIC's powers to act against bodies where any breach had occurred. However, the bottom line for the ACA

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164 Submission no. 48, p. 9.

165 Submission no. 44, p. 12.

166 Submission no. 48, p. 9.

167 Committee Hansard, p. 66.

168 Submission no. 16, p. 18.

169 Submission no. 44, p. 13.

170 Submission no. 16, p. 18.

was that, in the interests of safeguarding the operation of the licensing regime and for sound consumer protection standards, the exemption should be removed.[171]

Dispute resolution mechanisms

5.147 As indicated above, some professional bodies and consumer groups were concerned that the requirement that professional bodies act as regulators of their members would compromise their role as providers of independent advice both to these groups and to Government. A related concern was how effective and independent external dispute complaint boards and panels, of which there are six, will be under the new regime.

5.148 At hearings on the 13 June, the Chairman of the Australian Shareholders Association, Mr Ted Rofe, reported that, in his experience, the Financial Industries Complaints Service (FICS) is not, under the present regime, working well. He stated that there were complaints about delays and a perceived bias because the scheme is financed by industry.[172]

5.149 The issue of the independence of external dispute mechanisms, such as the FICS, emerged as a key issue for consumer representatives at hearings. Mr Connolly of the FSCPC told the Committee that:

> It is no secret that since 1999 the consumer movement…has been involved in a dispute with the schemes, the minister, the regulator, et cetera, about whether or not these schemes are actually independent. Our concerns are that the benchmarks state that consumer representatives should be appointed to the schemes in order to ensure independence. While that happened up until 1999, since that time the appointments to the specific schemes in financial services have been inappropriate, and the people appointed have not been consumer representatives and have not been people who have the confidence of the consumer movement, as required by the benchmarks. Those appointments have in fact undermined confidence in the schemes.[173]

5.150 Mr Connolly cited as examples the recent appointments made by the Minister of Financial Services and Regulation to FICS. He noted that the appointments did not result from a national advertising campaign, something which consumer groups had agreed (under some models) was a prerequisite.[174] Mr Connolly also judged the appointees did not have appropriate experience of consumer advocacy to qualify, given that merit based selection, preferably of individuals with casework or legal experience, is essential.[175]

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171 Submission no. 44, p. 13.

172 Committee Hansard, p. 139.

173 Committee Hansard, pp. 60–61

174 Committee Hansard, p. 70.

175 Committee Hansard, p. 72.

5.151 However, at hearings in relation to the Committee's oversight of ASIC on the 14 June, Deputy Chairman Ms Jillian Segal told the Committee that ASIC was not formally investigating the appointments as this was not 'appropriate'. Instead, she emphasised that ASIC, the Minister and consumers associations 'all have a common interest in ensuring that the schemes operate properly to provide consumers with the appropriate venue for alternative dispute resolution'.[176] In this regard, Mr Peter Kell, Executive Director, Consumer Protection, reported that ASIC is 'confident that the schemes can work well'.[177]

Commission disclosure on risk-based and insurance products

5.152 In contrast to submissions from life agents, reported elsewhere in this chapter, consumer and some other industry organisations argued that, in the interest of consumer protection, risk insurance products should not be exempted from commission disclosure requirements.

5.153 At hearings, the ACA's Ms Petschler emphasised that 'commission disclosure is a critical tool in improving transparency and raising consumer confidence in the financial market generally'.[178] The trigger for disclosure requirements in the legislation is whether commissions have the power to influence an adviser making a sale. In relation to disclosure of commissions on risk products the ACA observed that:

> While the argument is that commissions on risk products do not affect returns to consumers, we sincerely believe that the decision of agents to recommend one type of policy or one type of provider over another is influenced by commissions and can be influenced by commissions, and we are keen to make sure that consumers have adequate information to be able to assess the independence or otherwise of the advice they are receiving and to get the full information on the costs of the products that they are purchasing.[179]

5.154 The Consumer Credit Legal Service submitted that while a good agent may choose an insurance product based on its value to the consumer, and not on the agent's remuneration, it would be difficult for agents to resist higher commissions on some products.[180] ISFA agreed, pointing out that, in relation to risk products, high up-front commissions on product sales and 'volume bonuses' encourage agents to sell new products over servicing existing ones, and so should be disclosed to consumers.[181]

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176 Statutory Oversight of ASIC, Committee Hansard, pp. 76–77.

177 Committee Hansard, p. 77.

178 Committee Hansard, p. 56.

179 Committee Hansard, p. 56.

180 Submission no. 41, p. 3.

181 Supplementary Submission no. 29A, pp. 2–3.

5.155 The Consumer Credit Legal Service concluded—with the life agents—that disclosure of commissions will provide an incentive for insurance companies to reduce commissions. It saw, however, that the end result would be a lower product price for consumers.[182] IFSA, meanwhile, dismissed 'small business doomsday' scenarios, predicting that multi-agents will not survive the new regime. It submitted that while there are challenges in change, those businesses that rise to the challenges will, at the very least, retain their value.[183]

5.156 In this regard, Ms Petschler advised that the disclosure regime could actually benefit life agents. She noted that they could use disclosure documents to explain how commissions affect the price of a product sold by them compared with that sold by the salaried officers of large life offices, and could also advertise the additional services the agent provides.[184] She also saw that any concentration of influence in the marketplace by product manufacturers should be addressed through 'different regulatory structures and the intervention of regulators in the market place'.[185] She concluded that the consumer movement is confident that the implementation of the commission disclosure will increase competition and that consumers will get a better deal as a result.[186]

5.157 At hearings, Miss Lynn Ralph, CEO of IFSA, agreed that 'consumers will have increased confidence in the industry if they think nothing is hidden'. Miss Ralph supported full disclosure of fees and margins 'along the value chain' from manufacturer to distributor, with the qualification that disclosure of product margins may be unhelpful; given it is not understood how influential price is for consumers when buying a range of financial services. She noted that IFSA intends to research this later in the year.[187]

5.158 Asked about the possibility of exempting risk insurance agents from disclosure requirements, ASIC advised the Committee that it is arguable, under the present drafting of the legislation, that a provider may gain exemption if it could be proved that commissions in no way influenced their promotion of a particular product over another. Mr Ian Johnston, Executive Director, Financial Services Regulation, emphasised, however, that suggestions that tied agents would be exempt from disclosure requirements was not borne out by examination of the legislation.[188]

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182 Submission no. 41, p. 3.

183 Supplementary Submission no. 29A, p. 3.

184 Committee Hansard, p. 57.

185 Committee Hansard, p. 60.

186 Committee Hansard, p. 60.

187 Committee Hansard, pp. 126; 124.

188 Committee Hansard, p. 358.

Pressure selling

5.159 Consumer organisations were unified in their concerns that the Bill does not go far enough to control pressure selling of financial products, particularly when the sale is not face to face, that is, when it is conducted over the telephone or through telemaketing, internet, direct mail or by other sales methods.

5.160 In its submission, the ACA suggested that the Bill should provide ASIC with wider powers to prohibit unsolicited telemarketing, and 'step in' powers to intervene when other pressure selling techniques emerge in the market place.[189] In recommending a stronger role for ASIC, Mr Connolly advised the Committee that the ACA's object was not to create an over regulated industry where legal action, which would be expensive and protracted, was the consumer's main recourse.[190] Instead, the ACA wanted consumers to be better informed about financial service products and to exercise choice:

> where it is their decision to go and consider financial services products, to get a financial plan, and they are not in a pressure situation where someone has visited them at home or in the workplace or contacted them on the telephone when they are trying to get the kids to bed…[191]

5.161 At this stage, however, the ACA judged that the Bill did little to support this development or to protect consumers, especially low income consumers, from unconscionable conduct.[192] The ACA, with the Financial Services Association, were particularly concerned about the failure of the legislation to address the growth in pressure selling of superannuation products over the telephone, especially given the implications of the Government's proposed choice legislation.[193]

5.162 At hearings, the Department of the Treasury's Ms Vroombout explained that the prohibition on cold calling was limited to unsolicited meetings with another person because that was the situation in which the consumer has least control. She also advised that the legislation is an attempt to balance consumers' needs while not unduly limiting the marketing of products.[194]

Disclosure of ethical investment policies

5.163 A number of organisations and individuals asked that the Bill's disclosure regime should require declaration of non-financial considerations in investment decisions. In particular, submissions requested that disclosure obligations for a

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189 Submission no. 44, p. 10.

190 Committee Hansard, p. 75.

191 Committee Hansard, p. 75.

192 Committee Hansard, p. 75.

193 Committee Hansard, p. 56, and see ACA Submission no. 44, p. 10; FSCPC Submission no. 37, pp. 4–5.

194 Committee Hansard, p. 304.

financial product with an investment component require that the seller or issuer should, at the point of sale, disclose to the retail client:

> The extent (if at all) to which environmental, social or ethical considerations are taken into account in the selection, retention and realisation of the investments.[195]

5.164 The Australian Conservation Foundation and the Ethical Investment Association (EIA) appeared before the Committee to explain how socially responsible investment (SRI) or ethical investment disclosure fits within the new disclosure requirements laid down by the Bill.

5.165 The Australian Conservation Foundation argued that ethical disclosure at point of sale is essential to provide consumers with ‘sufficient information to make informed decisions’ about acquisition of financial products, as required by the Bill. Mr Michael Kerr explained that the proposed requirement should apply to all collective products, such as superannuation, which are overseen by a fund manager.[196] The organisation, along with the EIA, discounted suggestions that what is ‘ethical’ cannot be legislated on, arguing that the term must be open ended to allow for diversity of focus.[197]

5.166 These organisations also reported that their proposal is made in recognition of growing demand for ethical investment products in Australia and overseas. In its submission the EIA reported that:

- a KPMG survey conducted in mid 2000 revealed that 69 per cent of Australians would consider a socially responsible investment fund if given the opportunity; and
- the United Kingdom now requires pension trustees to disclose their policy on socially responsible investment.[198]

5.167 At hearings, the Australian Conservation Foundation also reported that ethical investment has grown by 50 per cent in the United States and the UK during the past decade, with the equivalent of $4.05 trillion currently invested in the USA. Mr Kerr stated that one billion dollars is currently in ethical investments in Australia, with mainstream financial institutions such as Westpac, AMP, Rothschild and the Commonwealth Bank participating.[199]

5.168 However, in a report on SRI in Australia (prepared by the Allen Consulting Group and tabled by the Ethical Investment Associations on 14 June) the Australian

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195 See for example, Submissions nos 44, 68, and group Submission no. 69.

196 Submission no 22, pp. 3–4, and Committee Hansard, p. 49.

197 See ACF Committee Hansard, pp. 49–50, and EIA Committee Hansard, p. 245.

198 Submission no. 68, pp. 1–2.

199 Committee Hansard, pp. 46–47.

market was judged to be slow to take up ethical investment, with the present sector seen as 'immature and fragmented'.[200] The EIA explained at hearings that, despite consumer and investor interest, the majority of investment managers are not responding to demands for disclosure of the nature of investments being made.[201]

5.169 For this reason, the representatives of the EIA submitted that the ethical disclosure requirement should be included in the legislation, rather than left as a marketing tool.[202] Mr David Andrews of Glebe Asset Management advised that ethical disclosure requirements would also provide an opportunity to secure a more transparent ethical investment market, as managers at present can be 'very thin' on explanations of their investment methodology.[203]

5.170 The introduction of an ethical disclosure clause was supported in principle by other organisations including CPA Australia and the AMP Limited. However, they also cautioned the Committee that the inclusion of such a clause might be counterproductive to the purposes of the Bill, or have potential negative effects for consumers.[204]

5.171 In this regard, ISFA told the Committee that it did not support the introduction of any measures that would move the legislation back towards the more prescriptive regimes under which we currently operate. Miss Ralph considered that the inclusion of specific disclosure requirements may actually disadvantage consumers if every organisation was made to make a statement, as against a market situation where those companies with genuine claims would advertise the fact.[205]

5.172 The AMP, which has launched its own SRI fund, agreed, also cautioning that differences in the superannuation industry between that in the UK and Australia made legislating for ethical investment disclosure requirements inappropriate in the context of the Bill. It recommended that the issue should be taken forward after consultation with the investment community.[206]

Superannuation

Introduction

5.173 In its submission, the Association of Australian Superannuation Funds of Australia (ASFA) observed that the treatment of superannuation as a 'financial

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200 *Socially Responsible Investment in Australia*, A report prepared by the Allen Consulting Group for the Ethical Investment Working Group, 2000, p. 2.

201 Committee Hansard, p. 248.

202 Committee Hansard, p. 248.

203 Committee Hansard, p. 249.

204 CPA Committee Hansard, pp. 39–40, and AMP Submission no 49, p. 3.

205 Committee Hansard, p. 122.

206 Submission no. 49, pp. 3–4.

product' under the Bill poses special challenges. This is because of the distinctive nature of Australia's superannuation industry: it is a compulsory system based on long term investment (normally preserved until retirement) and has many financially unsophisticated investors.[207]

5.174 ASFA saw problems for the superannuation industry arising from the present definition of financial advice. It noted that, particularly under proposed choice of funds legislation, employers may be seen to be giving 'financial advice' to employees about their superannuation arrangements, and so would fall within licensing requirements.[208] ASFA also warned that licensing requirements relating to training and competency may undermine member representation on trustee boards; an important consumer and prudential safeguard which ensures fund members' long-term interests are adequately represented.[209]

5.175 At present, the standards for the operation of superannuation funds and the behaviour of trustees are currently set through the *Superannuation Industry (Supervision) Act 1993* [the SIS Act]. A number of organisations making submissions to the inquiry expressed concern that present satisfactory arrangements established by the SIS Act will not be continued under the new regime; or that attempts to regulate superannuation under the Bill may prove less than efficient.

5.176 The Institute of Chartered Accountants in Australia and CPA Australia feared that the inclusion of disclosure requirements for superannuation under the Bill will be a 'dilution of the complete package approach' under the SIS Act. They predicted that compliance costs will increase.[210] The Corporate Super Association was concerned that the distinction made under the SIS Act between 'not-for-profit' and public offer superannuation funds is not carried into the new regime.[211]

5.177 Accordingly, ASFA advised the Committee that the new regulation framework should seek to ensure that its standards are enforced in a consistent way, and do not result in or require a duplication of effort or an increase in costs for complying funds. At the same time, the reforms should proceed without any diminution of existing consumer protection for fund members. It concluded that: 'Superannuation cannot and should not be simplistically equated with other managed investments'.[212]

5.178 In this regard, Dr Michaela Anderson, Director of ASFA, recommended that the present Bill should clearly recognise the current dispute arrangements outlined

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207 Submission no. 16, pp. 7–8.

208 Submission no. 16, p. 14.

209 Submission no. 16, p. 16.

210 Submission no. 40, p. 3.

211 Submission no. 60, pp. 2–3.

212 Submission no. 16, p. 7, and see Committee Hansard, p. 191.

under the SIS Act. ASFA wanted the superior regulatory powers of the Superannuation Complaints Tribunal Committee (SCTC) preserved as appropriate to superannuation's special nature, and wanted to avoid duplication.[213] Dr Anderson noted that it may be necessary to broaden the SCTC's powers to address any identified jurisdictional problems. ASFA also supported any requirement for superannuation licensees to hold trustee liability insurance to comply with the Bill.[214]

5.179 In addition, Dr Anderson emphasised the importance of the disclosure requirements for superannuation products. She advised the Committee that these requirements should be devised in full recognition that superannuation is compulsory and that many fund members are financially unsophisticated. Dr Anderson reported that ASFA considers that the details of the disclosure requirements should be set down in the regulations, and should be formulated with the consumer in mind. She advised that ASFA, which had conducted consumer research, could offer valuable assistance in this regard.[215]

5.180 At hearings on the 27 June 2001, the Department of the Treasury confirmed that coverage of superannuation funds under the Bill is significantly dependent on the choice of funds legislation. Two sets of regulations are presently being drafted to deal with the possibility that the choice legislation will not be passed.[216]

Retail/wholesale distinction relating to superannuation products

5.181 A key distinction in the legislation is that between the provision of financial products on a 'wholesale' or 'retail' basis. The ruling that 'all superannuation products are retail' activates the requirement for full disclosure to the consumer. While this aspect of the legislation was generally approved, some organisations identified unintended consequences which they judged may have negative effects for the superannuation industry or for consumers.

5.182 In its submission, ASFA strongly supported the Bill's distinction and the provisions declaring that all persons issued superannuation products and Retirement Savings Account (RSA) products are retail clients in all circumstances. ASFA was concerned, however, that the legislation remains unclear on whether related products, such as allocated pensions or annuities which may be offered by life offices, are included in the definition of superannuation product. It recommended that all such products should be considered retail for the purposes of those provisions of the Bill.[217]

5.183 The Australian Consumers Association also stressed its support for the provisions that bring superannuation products under the retail category. It emphasised

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213 Committee Hansard, p. 195.

214 Committee Hansard, p. 193.

215 Committee Hansard, p. 193.

216 Committee Hansard, pp. 272–73.

217 Submission no 16, p. 12.

that the possible introduction of superannuation 'choice' legislation makes it 'critical' that:

> …strong disclosure, selling practices, cooling off, compensation and enforcement provisions are established for all clients in superannuation to ensure Australian consumers have protection against mis-selling and abuses which have emerged in other markets…such as the UK and Chile, with disastrous individual and public policy results. [218]

5.184 In this regard, the ACA urged that the Government should 'carefully review' any exemptions which would deem certain transactions 'wholesale', and so outside the retail disclosure requirements. A particular area of concern related to the 'product value test'—where retail disclosure requirements on investment transactions over a specified amount would be waived on the assumption that investors are 'sophisticated'.[219]

- *product value test exemptions*

5.185 ASFA, the Institute of Chartered Accountants in Australia and CPA Australia were in agreement that the Bill's 'product value test' exemptions, proposed under the definition of retail client, could cause many inexperienced investors to lose the benefits of retail client protection.[220] These concerns were also shared by consumer interest organisations such as the Financial Services Consumer Policy Centre and the Australian Consumers Association (ACA).[221]

5.186 As foreshadowed in the Explanatory Memorandum to the Bill, the 'product value test' is likely to be set at $500 000, consistent with the Corporations Law. As ASFA has noted, the threshold of the test in Corporations Law has existed for many years and has not been indexed.[222] Submissions argued that the value test threshold therefore does not respond to the present superannuation profiles of many retirees, many of whom will retire with a lump sum exceeding the test amount. This means that many unsophisticated investors will be vulnerable, through not being adequately informed, or being misinformed, about their post superannuation investment choices.[223]

5.187 To address the problem, it was suggested that the threshold level of the product value test should be raised to ensure most consumers receiving lump sum payments are covered; or, that the product value test be removed.

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218 Submission no. 44, p. 14.

219 Submission no. 44, pp. 14–15

220 Submission no. 16, p. 13 and Submission no. 40, p. 3.

221 Submission nos 37 and 44, and see Committee Hansard, p. 58.

222 Submission no. 16, p. 13.

223 ASFA, Institute of Chartered Accountants and CPA Australia, ACA and Financial Services Consumer Policy Centre. See submission nos 16, p. 12; 40, p. 3; 44, p. 15; and 37, p. 6.

5.188 The ASFA and the Financial Services Consumer Policy Centre proposed that the test value could be set at the pension Reasonable Benefits Limit (indexed and currently at just over one million dollars).[224] They advised caution, however, with ASFA warning of possible unintended consequences if superannuation funds using related unregistered unit trusts are treated as 'retail clients'.[225]

5.189 In relation to the removal of the exemption, ASFA and the ACA noted that the Bill separately provides an exemption for high wealth individuals to be treated as wholesale clients, subject to certain tests, if they request it.[226] In this context, ISFA advised that the professional investor test should apply for superannuation purposes, as it would pick up trustees and others who control significant funds and who are 'genuinely wholesale'.[227]

- *status of pooled superannuation trusts*

5.190 However, the Committee was also lobbied by other groups who saw inefficiencies arising from the Bill's treatment of *all* superannuation products as retail when some, it was argued, are genuinely wholesale. The point at issue was the Bill's application to pooled superannuation trusts (PSTs). PSTs are unit trusts with a corporate trustee that operate as investment vehicles for other superannuation funds. As superannuation entities they are required to meet SIS Act conditions and so would be defined as 'retail' under the new legislation.[228]

5.191 The capturing of PSTs under the retail distinction was widely criticised. In evidence to the Committee, IFSA asserted that the Bill is in fact 'seriously flawed' in this respect. It stated:

> While IFSA would not query the desirability of treating as retail, advice and dealings by small superannuation funds and individual consumers with substantial funds (eg. retirees with over $500 000 to invest), we believe that significant problems and inefficiencies will arise from treating genuine wholesale transactions this way.[229]

5.192 The AMP noted in its submission that, for the past 15 years, PSTs have been regulated as investments offered to wholesale or sophisticated investors. By way of example, the AMP reported that the AMP Henderson Pooled Superannuation Trust currently has a minimum initial investment of $1 million per investor.[230] The BT Financial Group explained that investments in PSTs can only be made by trustees of

224 Submission no. 16, p. 13 and Submission no. 37, p. 6.

225 Submission no. 16, p. 13.

226 Submission no. 16, pp. 12–13; and Submission no. 44, pp. 14–15.

227 Committee Hansard, p. 123.

228 Supplementary Submission no. 16A, p. 1.

229 Submission no. 29, p. 3.

230 Submission no. 49, p. 2.

regulated superannuation funds or approved deposit funds; trustees who have already satisfied the Australian Prudential Regulatory Authority (APRA) of their financial acumen. It also noted that these same trustees, if investing in self-managed investment schemes, would be treated as 'wholesale'.[231] The AMP, Freehills, and the BT Financial Group agreed that genuine wholesale investors should not be treated as retail, and that there should be a carve out for 'professional' and 'sophisticated' investors, such as trustees investing in PSTs.[232]

5.193 The BT Financial Group and IFSA also saw that 'significant problems and inefficiencies' for PSTs would result under the present legislation.[233] The Institute of Chartered Accountants in Australia and CPA Australia predicted that additional complexity, with some funds being treated as wholesale clients and others as retail, will result in a lowered adherence to disclosure standards and an increase in costs.[234]

5.194 The Chartered Secretaries Australia added that the retail requirement may also prevent some otherwise useful products being released in the PST format because of the stringency of retail disclosure requirements, compared with those for a sophisticated investor. The organisation noted that PST products were created, in the first instance, to service the needs of the sophisticated investor.[235]

5.195 In a supplementary submission, ASFA gave consideration to the position of PSTs. It observed that, under the present drafting of the Bill, wholesale exemptions could not be obtained for PSTs, even if the funds held were in excess of $10 million. ASFA concluded that, given the high value investment involved, to subject PSTs to retail requirements would be 'an unnecessary protection generating unwarranted costs and complexity'.[236]

5.196 ASFA recommended that the current Corporations Law 'professional investor' exemption for superannuation funds with assets in excess of $10 million, when these funds are invested in pooled superannuation trusts, should be retained. It considered, however, that smaller funds with assets less than that amount when investing in PSTs should retain retail clients status.[237]

- *Government response on wholesale/retail issues*

5.197 In his letter of 25 June to the Chairman of the Committee, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, indicated that proposed amendments to the Bill will ensure that 'the retail/wholesale distinction works

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231 Submission no. 45, p. 2.

232 Submission nos 49, p. 2; 54, p. 6; 45, p. 2.

233 IFSA Submission no. 29, p. 3, supported by BT Financial Group Submission no. 45, p. 2.

234 Submission no. 40, p. 3.

235 Submission no. 65, p. 6.

236 Supplementary Submission no. 16A, p. 2.

237 Supplementary Submission no. 16A, p. 2.

appropriately in relation to superannuation products'.[238] At hearings in Canberra on 27 June, the Department of the Treasury confirmed the Minister's intention, advising, however, that issues relating to the product value test and to the treatment of PSTs will be addressed in the regulations currently being drafted by the Department.

5.198 In relation to the product value test, Ms Vroombout told the Committee that the Department envisaged that the regulations would specify that a different product limit for superannuation pay-outs should apply. She also advised that superannuation associations' suggestions that the Reasonable Benefit Limit should be adopted would certainly be considered in the drafting.[239]

5.199 Ms Vroombout also told the Committee that the Department had received representations relating to PSTs and was considering its options; such as whether the disclosure requirements should apply to dealings of a pooled super trust with other superannuation funds, or whether the professional investor test should be applied.[240]

Exemptions for 'not-for-profit' superannuation funds

5.200 A number of organisations protested that the new requirements for treatment of not-for-profit superannuation funds were inappropriate. The organisations noted that the SIS Act provides distinct and separate regulation for not-for-profit, as against public offer schemes, and argued that this distinction should be maintained under the new regime, or that an exemption should be provided for some schemes, as for self-managed superannuation funds.

5.201 Freehills argued that the present legislation was not intended to cover not-for-profit funds, which are better catered for by the provisions in the SIS Act. The firm noted that the recommendations for the uniform regulation of the financial sector in the Financial System Inquiry (Wallis) Report do not naturally apply to the operations of not-for-profit funds.[241] Freehills further judged that the application of the proposed licensing regime to not-for-profit funds seems to be based on the flawed perception that these funds were required to be licensed under the SIS Act, which is not the case.[242]

5.202 In their submissions, the Corporate Super Association and Freehills explained that while public offer funds fit comfortably under the definition of financial product, as defined by the legislation, this is not the case for not-for-profit funds.[243] Freehills defined not-for-profit funds as:

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238 Document tabled on 25 June 2001, p. 2.

239 Committee Hansard, p. 298.

240 Committee Hansard, p. 272.

241 Submission no. 54, p. 2.

242 Submission no. 54, p. 3

243 Submission nos 60, p. 1 and 54, p. 1.

- corporate funds operated solely for the employees of a particular employer; and
- industry funds operated for the employees of employers within a given industry.[244]

5.203 The Corporate Super Association clarified the definition, noting that there are differences between industry funds and corporate funds, but that both these types of funds have board trustees structured to comply with the equal representation rules set by the SIS Act, and are defined as 'not-for-profit'.[245]

5.204 In its submission, the Association further explained that trustee arrangements in not-for-profit funds are not equivalent to those in commercially oriented public offer funds. Many use a representative trustee structure, where non-expert trustees are elected to play a governance role, administering the fund and monitoring the activities of experts appointed to make investment decisions.[246] The schemes are designed to build appropriate incentive and benefit structures for employees and do not involve payment of commissions or fees.[247]

5.205 At hearings on 25 June in Canberra, the Chairman of the Corporate Super Association, Mr Mark Cerche, told the Committee that management costs in the corporate funds sector are at a ratio of approximately 0.7 per cent of the $120 million plus funds managed. The equivalent management expense in a publicly offered fund would be in excess of 1.4 per cent.[248] In addition, he emphasised that other than 'sitting fees' of perhaps $500 a year, corporate board trustees are not paid employees of the fund and are not licensed to give investment advice.[249]

5.206 The Church Superannuation Funds Cooperation Committee reported that the representative structure allows members a greater role in management of the funds, building confidence and contributing to a very low level of complaint.[250] The Corporate Super Association also reported a lack of history of abuse of the fiduciary relationship or serious compliance breaches amongst major corporate funds. It noted, instead, that serious breaches and frauds have occurred where a 'professional' trustee, adviser or administrator has been at fault.[251]

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244 Submission no. 54, p. 1.

245 Corporate funds function with employer, rather than union, support and offer members defined benefit schemes, while industry funds offer accumulation benefits. See Committee Hansard, p. 263. The SIS Act equal representation rules require that half of the trustees are elected by the employer and half are elected on behalf of members.

246 Submission no. 60, p. 3.

247 Submission no. 60, p. 1.

248 Committee Hansard, p. 254.

249 Committee Hansard, pp. 259; 260.

250 Submission no. 67, p. 2.

251 Submission no. 60, p. 3.

5.207 In evidence to the Committee in Sydney on 14 June, ASFA's Director Dr Anderson explained that, while not licensed by ASIC, non-public offer fund trustees have to demonstrate their adherence to 'onerous requirements' set down by the SIS Act. She reported:

> Trustees are required to have both their financial statements and compliance with SIS audited on an annual basis and are subject to reviews by APRA. The consumer protection requirements of SIS include: disclosure requirements at fund entry, annually on significant events, at exit and on request; and access to internal and external complaints mechanisms. Equal representation on trustee boards is a consumer protection measure and also, it is often argued, a prudential measure. SIS provisions which disqualify persons convicted of dishonest behaviour for being trustees or investment managers, the covenants at section 52 and standards relating to records, accounts and all other issues are as much consumer protection as about prudential regulation.[252]

5.208 Given this, there was agreement in the evidence that the new regime could impose an additional, and yet unproductive, layer of regulation on corporate funds that would increase costs and impair functioning administrative structures. The end result, organisations argued, would be a reduction in the number of not-for-profit funds.

5.209 The Corporate Super Association advised the Committee that if capital adequacy is a criteria for holding a license then the Bill will knock 'dead' the corporate superannuation industry.[253] It predicted that employers would cease to provide corporate funds, choosing to meet only minimal Superannuation Guarantee Act requirements through public offer funds, with a resulting greater reliance on Government pensions.[254] The Institute of Chartered Accountants of Australia and CPA Australia also observed that, if funds were to comply with licensing requirements, the costs of appointing a licensee to advise staff would have to be borne by fund members.[255]

5.210 To correct the situation, ASFA recommended that all SIS Act regulated complying non self-managed superannuation funds should be treated the same as existing licensees for the purposes of the new regime. This means that trustees should be able to obtain an Australian financial services licence to cover their existing activities through the making of a declaration.[256]

5.211 The Corporate Super Association asked that a specific exemption should be made under the licensing regime for not-for-profit funds. In its submission the

252 Committee Hansard, p. 192.

253 Committee Hansard, p. 256.

254 Submission no. 60, p. 3.

255 Submission no. 40, p. 4.

256 Committee Hansard, p. 192.

Association, along with Freehills, also recommended that the distinction in the SIS Act between not-for-profit and public offer funds should be retained.[257] The Church Superannuation Funds Cooperation Committee asked that church funds be exempted from the licensing requirements in the same way as self-managed funds; that is, within the legislation itself, and not in the regulations. The CSFCC also requested market testing of disclosure requirements. [258]

5.212 William M Mercer Pty Ltd agreed that 'there is a strong justification to exclude the trustees of employer sponsored superannuation funds from the licensing… requirement' under the Bill.[259] Alternatively, it saw that if not-for-profit funds are to come under the purview of the Bill, there is a need to provide a specific exemption for superannuation trustees like that provided for dealers in securities under the Corporations Law. Mercer suggested that the exemption should allow fund trustees wishing to outsource to do so without a licence, where dealing activities are for the administration and management of fund assets. Mercer did not support, however, any exemption for not-for-profit funds from the disclosure regime.[260]

5.213 At hearings in Canberra on 27 June, Ms Vroombout of the Department of the Treasury told the Committee that capital adequacy would not be an issue for corporate superannuation funds as they are regulated by APRA.[261]

5.214 In relation to the situation of superannuation board trustees, Ms Vroombout stated that, to address concerns, the Bill's amendment on multiple trustees had been introduced to allow for competencies to be held collectively among trustees on superannuation boards.[262] She stated that outsourcing is not outlawed by the Bill, and that the competency of trustees would stand on whether they gave financial advice or not. Their status in this respect would be determined on a collective basis by ASIC.[263]

5.215 ASIC confirmed this interpretation, reporting that, as articulated in its policy paper, it would adopt 'flexible minimum standards' in assessing the competency requirements of trustee boards.[264]

5.216 Ms Vroombout of the Department of the Treasury also advised the Committee that until the commencement of choice of fund legislation, corporate superannuation funds would be exempted from the operation of the Bill by a regulation.[265]

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257 Submission no. 54, p. 3.

258 Submission no. 67, pp. 5; 2.

259 Submission no. 28, p. 1.

260 Submission no. 28, pp. 4; 1.

261 Committee Hansard, p. 290.

262 Committee Hansard, p. 290.

263 Committee Hansard, p. 291–92.

264 Committee Hansard, p. 329.

265 Committee Hansard, pp. 272–73.