CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

Support for the Bill

6.1 The Committee concludes that the Financial Services Reform Bill 2001 has been generally well received by the financial services industry. In particular, the Committee notes that key stakeholders are satisfied with the main objectives of the Bill. The Committee also concludes that the consultation process with interest groups, which preceded the final Bill, was appropriate and effective. The Committee accepts that there are problems with a number of aspects of the Bill, but that these do not affect overall acceptance of the Bill. The Committee therefore **recommends** that the Bill be passed.

Concerns about the process

6.2 The Committee concludes that certain reservations expressed about the Bill are justified because the full nature of its operation cannot be known until the Australian Securities and Investments Commission (ASIC) releases its policy papers, and the Department of the Treasury has finished drafting the regulations.

6.3 The Committee also endorses concerns that the tight timeframe allowed for finalising the actual legislation and the regulations will not allow affected sectors to participate fully in the drafting processes.

6.4 The Committee is sympathetic to concerns that lack of detail in the Bill might place too great a degree of responsibility on ASIC to interpret the legislation, thus leading to reduced certainty about the Bill's operation. The Committee concludes that ASIC's resources are already stretched and any further responsibilities stemming from the current Bill would require additional funding.

6.5 The Committee accepts that another concern for industry participants is the timeframe for the transitional arrangements for the move to the new financial regime. The Committee acknowledges some industry unease about ASIC's expectations that industry can meet requirements, including the establishment of mechanisms for self-regulation, within the expected timeframe.

6.6 The Committee concludes, however, that many of these concerns will have been allayed by the 5 April 2001 statement by the Minister for Financial Services, the Hon Joe Hockey MP, that the commencement date of 1 October 2001 for the new regime is simply the date on which persons may comply with the new regime if they wish. Those who need more time to comply will generally have up to 1 October 2003.

6.7 The Committee acknowledges the desirability of commencing the new regime as soon as possible, but **recommends** that the two year transitional period be retained in order to assist those in the financial services industry to comply with the new

regime. The Committee also **recommends** that the Government explore the possibility of additional funding for ASIC to allow it to meet its new responsibilities.

Revoking of the media exemption

6.8 The Committee received substantial evidence from media organisations that the imposition of the Bill, in absence of the exemption provided under the Corporations Law, will impose real operational difficulties on the media. These in turn would fundamentally challenge information providers' ability to fully inform consumers on the threshold of financial reform.

6.9 The Committee notes the Minister's statement that there was no intention that the Bill should change the practical effect of licensing requirements for media organisations. In this respect, the Committee observes that the media has no quarrel with the requirement that those paid to deliver financial advice, by whatever medium, should be subject to the Bill's licensing requirements. Instead, its concerns focus on the perceived threat to the independent provision of information about financial services, which would run counter to Australia's commitments under the World Trade Organisation's General Agreement on Trade in Services (GATs).

6.10 The Committee therefore considers that revoking the media exemption, without other adequate provisions being in place under the Bill, will have unintended consequences for Australia's media providers and for consumers, and may have broader ramifications for Australia in an international context. In this regard, the Committee notes the Minister's commitment, in his letter to the Chairman of 25 June, that a regulation will be cast, after consultation with the industry, to ensure that the media will be exempted under the definition of general advice, subject to certain disclosure requirements.

6.11 The Committee recognises that this was intended to give media organisations the same degree of certainty to that provided previously under the Corporations Law. However, the Committee is persuaded by evidence that the matter should be addressed in the legislation, and not in the regulations. The Committee therefore welcomes the Minister's further public commitment that the legislation will be amended so that media organisations regain the certainty provided by the Corporations Law exemption.

6.12 The Committee **recommends** that Bill should be amended as follows to provide that result:

(1) A media provider is not required to obtain an Australian Financial Services Licence for a prescribed publication which contains:

- a) general advice; or
- b) personal advice, unless:
  - (i) the media provider carries on the business of providing personal advice, or

(ii) the media provider's sole or principal purpose is to influence people in making decisions in relation to a particular financial product or class of financial products.

(2) For the purposes of sub-section (1):

media provider means a person who carries on a business with the sole or principal purpose of providing information to the public and includes, without limitation:

(a) a person licensed under the *Broadcasting Services Act 1992*, the Australian Broadcasting Corporation, and the Special Broadcasting Service Corporation;

(b) a publisher of a newspaper or periodical that is generally available to the public, including over the internet;

(c) a publisher of an information service that is generally available to the public by the means of transmission, sound recordings, video recordings or data recordings, or over the internet;

(d) a person who is employed by, or provides services to a person described by (a), (b) or (c) above, as a journalist or commentator.

prescribed publication means a publication made by a media provider in the course of carrying on its business of providing information to the public.

The regulations may contain specific provisions qualifying any of the above meanings.

Telephone tape recording proposal

6.13 On consideration of the evidence, the Committee concludes with industry that the Bill's provisions on this issue have been drafted with slight appreciation of the nature and operational features of the shareholder telephone canvassing industry. The Committee notes that the confidential nature of contacts made during takeovers is considered essential to the bid process, and that the high degree of self-regulation imposed is designed to protect both the client and the seller. The Committee also concedes that the requirement to tape record all communications between targets and bidders in all circumstances may be neither practically nor financially feasible for industry participants.

6.14 In this respect, the Committee sees merit in the Minister's commitment, also articulated in the letter referred to above, that an amendment will be moved to limit the scope of the proposal's application. After amendment, the Bill will require that only calls to retail shareholders during a takeover bid need be recorded.

6.15 However, given the degree of concern expressed about the inappropriateness of the proposal *per se*, the Committee believes that the Government should review the

objectives of the proposal, and consider what alternative approaches would marry better with the present operating features of the industry.

6.16 The Committee therefore **recommends** that the Government should remove from the Bill the provisions relating to the recording proposal and consider other options, such as whether the Australian Securities and Investments Commission (ASIC) could play a role in supporting or monitoring self-regulation in the telephone shareholder canvassing industry.

Issues relating to Australia as an international financial centre

6.17 In its report on the draft Financial Services Reform Bill, the Committee noted that the intention of the Bill was to improve Australia's international competitive position and to enhance its role as an international financial centre. In this context the Committee endorsed a number of recommendations made by the Australian Stock Exchange Limited (ASX), in particular a recommendation to increase the shareholder limit on the ASX from 5 per cent to 15 per cent. The Government subsequently announced that it had accepted this recommendation, but did not accept all of the other matters endorsed by the Committee.

6.18 In relation to the final Bill the Committee accepts again the advice of the ASX that the Bill is deficient as it affects Australia's international competitiveness in an integrated global market. The Committee endorses the ASX position that the Bill does not provide a level playing field in that it fails to facilitate links between the ASX and foreign exchanges, to reduce duplication of legislative requirements or to provide a framework for mutual recognition. The Committee also accepts advice from Morgan Stanley, Dean Witter and Goldman Sachs that concessions in the Bill for the provision of financial services by overseas entities to wholesale clients in Australia are insufficient. The result may be that the Bill will deter overseas financial institutions from providing a full range of services to their Australian corporate clients. The Committee considers that Australia's competitive position and its role as an international financial centre are of critical importance to the success or otherwise of the aims of the Bill. It would be unacceptable if the Bill did not provide the flexible and responsive supervisory framework necessary to achieve these aims.

6.19 The Committee therefore **recommends** that the Bill be amended to address these concerns. In particular, the Committee endorses the view of the ASX that the Bill could provide a better framework for mutual recognition by the use of specific policy directions for the exemption and modification powers in the Bill. The Committee **recommends** that the general objects clause of the Bill (s.760A) and the matters to be taken into account by the Minister before making Australian market licensing decisions (s.798A) or clearing and settlement licence decisions (s.827A), should be amended to include this policy intention.

6.20 The Committee also endorses the views of Morgan Stanley and Goldman Sachs that the territorial jurisdiction of the Bill (s.911D) is very wide and may have adverse unintended consequences; and that the Bill does not include a provision equivalent to s.93(5) of the Corporations Law, under which unlicensed entities may

act through licensees without breaching the dealers licensing regime. The Committee **recommends** that the Bill be amended to remedy these defects.

Issues raised by authorised deposit taking institutions (ADI)

6.21 In its report on the draft Bill the Committee recommended that deposit products offered by ADI should be removed from the definition of financial product. The Committee did this to ensure the viability and level of services of ADI agencies in rural and regional areas, many of which would otherwise be forced to close. In its response to the report the Government undertook that the final Bill would exempt ADI deposit products that are for a term of two years or less and have no management or break fees. The Committee, however, concludes that this concession does not go far enough and that there are fundamental problems with the operation and clarity of the exemption. The Committee concludes that the exemption should apply to all basic deposit products. This would comply with the formal intention of the Government that the Bill should apply flexibly to basic deposit products because they are well understood by retail consumers.

6.22 The Committee concludes that the failure of the Bill to exempt all basic deposit products will lead to increased paperwork and administrative costs, which will be passed on to the consumer. The Committee also concludes that the two year limit for basic products is unnecessary and will not enhance consumer protection. In particular the Committee concludes that the present provision in the Bill will be a disincentive to offer such products in ADI agencies, which in remote areas are more usual than banks.

6.23 The Committee therefore **recommends** that the Bill should exempt from the definition of financial product all simple, well known basic deposit products and related non-cash payment systems. To achieve this the Bill should include an amendment in the same terms as set out in paragraph 2.21 of this report, excluding such products from the definition of financial product.

Issues which affect small business

6.24 The Committee accepted evidence that the Bill may adversely affect small business in relation to two main matters.

6.25 The first of these matters is the disclosure of the quantum of commission on risk financial products. As noted earlier, the Committee identified this as a key issue in its report on the draft Bill, recommending that the requirement be deleted. The evidence received by the Committee during the present inquiry has confirmed this earlier conclusion. The Committee accepts the views of small business operators that there is no consumer demand for this type of disclosure, which could impede legitimate market processes. The Committee rejects formal Government advice that quantum disclosure will help consumers identify the potential influences or conflicts of interest which an adviser may have in recommending a product. Instead, the Committee prefers the view of the small business associations, who advise that cost and service are the most important such influences, not commission. Accordingly, the

Committee **recommends** that the Bill should not require disclosure of the quantum of commission on risk products.

6.26 The second matter is the potential for the Bill to harm the continuing viability of small businesses and to reduce their market value. The Committee concludes that these are genuine and legitimate concerns which should be addressed. The Committee accepts evidence that the Bill appears to be biased in favour of the large providers of financial services, at the expense of small business, who are in direct contact with consumers. This bias is demonstrated in a number of ways. For instance, the Committee concludes that the required disclosure of the quantum of commission at the point of sale will put downward pressure on commissions, to the detriment of small business and the benefit of large operators. The Committee also concludes that the Bill will increase proportional costs more for small business than for large. There also seems to be adverse effects from changes made by the Bill to marketing techniques and to the relationship between principal and agent, affecting the agent's right to work and to receive remuneration. The Committee also accepts that the required training and educational qualifications will impact more severely on small operators. The Committee concludes therefore that unless it is amended the Bill will have adverse effects on small business as opposed to more benign effects on big business.

6.27 The Committee accordingly **recommends** that the Bill be amended to provide that:

a) A licensee may revoke an authorisation without the consent of the authorised representative only if that representative is convicted of serious fraud. This will require an amendment of s.916A(4).

b) A person may be the authorised representative of two or more financial services licensees without the need for consent by each of those licensees. This will require an amendment of s.916C.

c) If ASIC suspends or cancels a financial services licence, each authorised representative of that licensee is deemed to continue to be authorised on the same terms and conditions as existed immediately prior to the suspension or cancellation. Proposed s. 915H of the Bill already appears to give ASIC the power to do this, but the Bill should be amended to make it a formal requirement.

d) If a licensee:

i) becomes an insolvent under administration;

ii) a creditor's or debtor's petition is presented under the *Bankruptcy Act 1966* against the partnership; or

iii) becomes an externally-administered body corporate;

then, notwithstanding any other law, all fees and commissions (including trailing commissions) payable to authorised representatives of the licensee as a consequence of the authorisation, shall continue to be paid to the representative as if the licensee had not become an insolvent, had a petition presented or become externally-administered.

e) If an authorised representative of one or more financial services licensees (the initial licensees), ceases to be the authorised representative of one or more of these initial licensees and instead becomes the authorised representative of one or more other financial services licensees, then all fees and commissions (including trailing commissions) payable to an authorised representative as a consequence of the authorisation or authorisations from the initial licensees, shall continue to be paid to the authorised representative as if the authorised representative were still the authorised representative of the initial licensees.

f) Upon commencement of this Act:

i) all agreements between insurance agents and life insurance companies relating to the retailing of life insurance products shall be deemed to continue in force even though the insurance agent may become an authorised representative;

ii) all fees and commissions (including trailing commissions) payable to agents as a consequence of any agency agreement shall continue to be paid to that agent;

iii) all benefits and contractual obligations relating to agency agreements (including buy-back clauses) shall continue to be enforceable as if this Act had not been passed; and

iv) nothing in this Act shall be deemed to prevent authorised representatives from entering into contracts (which may include buy-back clauses) with life insurance companies for the purpose of selling the products of those companies.

Issues relating to the insurance industry

6.28 The insurance industry raised a number of significant concerns with the Bill, as set out below.

Cooling off period

6.29 The Committee accepts the advice of insurance companies that there are circumstances where the cooling off period of 14 days, during which any financial product may be returned, may be an unnecessary and impractical level of consumer protection. Renewal notices for insurance policies are typically set out at least 14 days before the due date, but the cooling off period starts from the date of renewal or the date of the anniversary. The Committee concludes that existing industry practices

provide a sufficient level of consumer protection and therefore **recommends** that the cooling off period should not apply to insurance renewals for which at least 14 days notice is given.

6.30 The Committee does not accept that the cooling off period should apply only to the initial issue of a product and not to increase an existing holding. In these cases the Committee concludes that such a decision is a separate independent transaction. However, the Committee does accept and **recommends** that in the case of market linked financial products such as managed funds that the foreshadowed regulations should provide for adjustments to the amount repaid to reflect changes in the market.

Compulsory third party (CTP) and workers' compensation insurance

6.31 The Committee concludes that the Bill will have undesirable consequences for the operation of these classes of statutory insurance, which are provided in some States by government entities which will not be subject to the Bill and in other States by private companies to which the Bill will apply. This will result in regulatory complexity and increased costs for the private insurers. The Committee endorses the general unanimity of submissions that each of these classes of insurance should be excluded from the operation of the Bill until regulatory uniformity is achieved in the form of a uniform scheme. The Committee therefore **recommends** amendment of the Bill to provide this exclusion.

Insurance quotes by telephone

6.32 The Committee concludes that the Bill causes unnecessary and costly problems for insurance providers in relation to quotes given by telephone. In particular, the Committee concludes that disclosure requirements provide no appreciable protection for the large numbers of telephone inquirers who only want a quote for competitive purposes. In any event, if the consumer accepts the quote then full disclosure documentation is provided. The Committee accepts evidence that the requirement will put pressure on call centres and rural branches and agencies, increasing the cost of each policy by 5–8 per cent. The Committee **recommends** that the Bill should exclude from disclosure requirements the provision of a quotation alone for a general insurance product.

Travel insurance

6.33 The Committee concludes that the Bill will have adverse consequences in relation to travel insurance. The Committee concludes that some provisions of the Bill are inherently inappropriate for the sale of simple general insurance risk products such as travel insurance, which are inherently different from the investment products for which the Bill appears largely designed. The Bill could result in a breakdown of the distribution structure for these products, which represent a significant proportion of income for travel agents. The Committee therefore **recommends** that the Bill be amended and administrative action taken in line with the industry recommendations outlined earlier in this report.

Prohibition on hawking

6.34 The Committee concludes that there is no need to amend the Bill in relation to the hawking of general insurance products in rural areas. The Committee understands that the Bill permits insurance providers to contact insureds or potential insureds to make an appointment to discuss financial needs. The Committee concludes that personal visits by appointment by insurance providers to insureds is the form of contact most beneficial to consumers in rural areas and that the Bill provides for this.

Issues relating to declared professional bodies

6.35 In its report on the draft Bill the Committee concluded that concerns then expressed about the provisions relating to declared professional bodies were valid. The Government's response to the Committee's report rejected this position on the grounds that, from a consumer perspective, the loss suffered from poor financial advice provided incidentally by an accountant, for example, is no less serious than the loss suffered if the poor advice had been given by a full-time financial adviser. Nevertheless, the Government undertook to clarify the extent to which incidental advice is caught by the Bill.

6.36 The Committee concludes, however, that concerns remain in this area. The Committee accepts that a solicitor engaged to advise on all aspects of a matter in a professional capacity, cannot limit the advice provided to matters of a legal nature, and indeed may be liable for failing to give incidental financial advice. The Committee notes that it is therefore part of a solicitor's duty to provide financial advice in certain circumstances.

6.37 The Committee concludes that the exemption in the Bill for incidental advice does not include financial advice given in this way. Indeed, the Government's response indicates that the Bill is intended to apply to solicitors and accountants who provide incidental financial advice.

6.38 The Committee also concludes that at present few if any professional bodies will seek to be declared for the purposes of the Bill. The Committee endorses this position and questions whether ASIC should divert resources from its core regulatory function to assume responsibilities that could amount to the regulation of the legal and other professions.

6.39 The Committee endorses the concerns of accounting bodies that their members who offer traditional accounting services may come within the Bill.

6.40 The Committee concludes that there are fundamental problems with provisions in the Bill relating both to declared professional bodies and to incidental advice. The Committee **recommends** that the Bill be amended to exclude incidental advice from the requirements of the legislation.

Consumer protection issues

6.41 The Committee appreciates the considered response of consumer representatives on a Bill that aims to benefit consumers. The practical and conceptual issues raised include those addressed by industry associations, as well some additional aspects of the legislation which consumer groups judge may have adverse effects for consumers. The Committee notes that the Government has already addressed a number of these, with mirror provisions being installed under the ASIC Act, and the obligation to fairness reinstated.

6.42 The Committee also considers that it received satisfactory answers to some issues raised in relation to exemptions. In regard to exemptions for bank ‘clerks and cashiers’ and for those ‘acting outside authority’, the Department of the Treasury and ASIC explained how the Bill deals with the problems outlined. Similarly, the Committee considers that ASIC satisfactorily resolved issues raised about external dispute resolution mechanisms, and the Department of the Treasury about pressure selling.

6.43 In relation to industry self-regulation and disclosure issues, the Committee concludes that a balance has to be sought between consumer interests and what will benefit industry. The Committee has some sympathy, for example, with the case put by life agents and, as noted above, gave credence to their view that commission disclosure may unduly disadvantage them, while not necessarily benefiting consumers. On the other hand, taking into account consumer representatives’ concerns about the role of professional bodies as monitors of compliance, the Committee considers that there may be a need for some finetuning of oversight arrangements by ASIC.

6.44 The Committee therefore considers that ASIC may have to play a more active role in developing guidelines and monitoring industry self-regulation, and **recommends** that consultation with industry and consumer representatives should continue throughout the regime’s implementation to finetune that process.

6.45 Finally, while the Committee supports the development of ethical investment as part of the diversification of Australia’s investment portfolios, it concludes that the introduction of compulsory disclosure requirements would not be appropriate under the Bill. Instead, the Committee believes that market forces will deliver consumers the most transparent disclosure of socially responsible investment strategies by companies with a genuine commitment to applying them.

Superannuation

6.46 The Committee recognises that the Bill will take the superannuation industry in Australia into a new era, commensurate with its significance as the keystone of Government’s retirement policy. Concerns expressed about the adequacy of the Bill to supervise the industry, given its distinctive operation and its objectives, are understandable. However, the Committee believes that the introduction of the single licensing and disclosure regime will advantage and protect consumers.

6.47 In particular, the Bill's key distinction between wholesale and retail investors, and the definition of all superannuation products as retail, is made in recognition of the importance of protecting unsophisticated investors, such as superannuants with lump sums to invest. It is also designed to carve out 'wholesale' or sophisticated investment activities by individuals or large superannuation funds from the disclosure requirements.

6.48 In this regard, the Committee notes the Minister's assurance, in his letter of 25 June, that any perceived anomalies in the wholesale/retail distinction in relation to superannuation products will be addressed. The Committee therefore welcomed advice from the Department of the Treasury that the regulations would address concerns about the Product Value Test threshold. The Committee also heard that the Department of the Treasury was considering its options on the situation of pooled superannuation trusts (PSTs), such as applying the professional investor test.

6.49 The Committee agrees that the treatment of PSTs under the present legislation, in particular, is unworkable and concludes with the Association of Australian Superannuation Funds of Australia (ASFA) that the 'professional investor' test should be applied to PSTs under the new regime. The Committee therefore **recommends** 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 apply and that amendments should be made to the Bill to that effect.

6.50 On the basis of evidence, the Committee is satisfied that corporate and industry funds will not be adversely affected by the Bill. The Committee notes that corporate funds will not be subject to capital adequacy requirements as APRA-regulated bodies. Concerns about the effect of licensing requirements on superannuation boards of trustees also appear to have been largely addressed by the amendments allowing for competency to be held collectively across the board membership. The Committee concludes that, if fund management expertise is required, then a board member, or contracted expert, should be competent to fill that role. Similarly, if a board trustee or fund representative actually does give product advice, then he or she should be adequately qualified to do so, as required by the regime.

6.51 However, the Committee is aware that the superannuation industry will face challenges in the transitional period where regulation moves from SIS Act regulation to that introduced by the Bill. Industry representatives have commented that the transitional arrangements for the superannuation industry have not been clarified by the Financial Services Reform (Consequential Provisions Bill) 2001.

6.52 The Committee therefore **recommends** that ASIC and the Department of the Treasury should consult with superannuation industry representatives about the best measures to ensure a smooth transition for the superannuation industry into regulation by the Bill.

6.53 The Committee also **recommends** that to facilitate that process, and to ensure ongoing transparency and avoid duplication, the Government should consider preserving the powers of the Superannuation Complaints Tribunal Committee (SCTC) under the SIS Act as the appropriate dispute resolution mechanism for superannuation under the new regime.

Review of the operation of the Bill

6.54 The Committee commends the Government for foreshadowing in the Bill's Explanatory Memorandum that the reforms contained in the Bill will be reviewed by the Treasury, ASIC and CASAC 'after the two year transition period for their implementation.' The Committee, however, notes that as the transition period for the measures in the Bill is two years, it would be only after four or five years have elapsed since the Bill's commencement that the operation of the reforms contained in the Bill could be adequately examined. The Committee therefore **recommends** that, in addition to the foreshadowed review of the Bill's implementation, this Committee conducts a review of the operation of the Bill. The Committee further **recommends** that this second, operational review commence no later than five years after the commencement of the Bill.