AUSTRALIAN BANKERS' ASSOCIATION

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Dr Kathleen Dermody
Secretary
Parliamentary Joint Committee on Corporations and Financial Services
The Senate
Parliament House
CANBERRA 2600

By Email to: corporations.joint@aph.gov.au

Dear Dr Dermody,

Corporations Amendment Regulations 2003 (Batch 6);

Draft Regulations-Corporations Amendment Regulations 2003/04 (Batch 7); and

Draft Regulations-Corporations Amendment Regulations 2004 (Batch 8)

The Australian Bankers' Association (ABA) is pleased the Committee has initiated this inquiry.

We provide this submission for the consideration of the Committee to assist it with this inquiry.

Draft Regulations-Corporations Amendment Regulations 2003-04 (Batch 7)

The ABA wishes to raise a point in relation to proposed amended regulation 7.7.05B that deals with disclosing in the Financial Services Guide the identity of a providing entity that is acting as an authorised representative. This matter has been raised with Treasury.

The ABA welcomes the proposed amended regulation that will remove the need to identify the providing individual or corporate authorised representative in a FSG where their identity or remuneration is not material to the decision to acquire a

financial service. This is particularly relevant where a financial service is being provided on behalf of a licensee with staff engaged through an agency where it is the agency rather than the licensee that is the employer. A bank client could be concerned or confused to see the name of an entity as the provider other than the name of the bank. The ABA believes that the proposed amended regulation helps to resolve this circumstance.

However in the case where financial product advice is involved the draft regulation is limited to cases of general but not personal advice .

The amended regulation concentrates on the relevance or otherwise of the identity or remuneration of the authorised representative involved in the transaction. If this is right, the ABA submits that the regulation should be extended to an individual who provides financial product advice irrespective of whether that advice is general or personal advice. The reasons for this are:

1. paragraph 2 (c) of the proposed amendment explicitly concerns itself with the materiality of the individual's identity in respect of the decision by the retail client whether to obtain the financial service; and

2. in the normal course the identity of an authorised representative will be recorded by the licensee or the corporate authorised representative as part of their ordinary record-keeping and that this information would be available should the individual's identity be needed to be verified later on.

Also, for the sake of consistency, the proposed regulation should be extended to cover the situation where FSG information is required in the case of advice given on basic deposit products and related non-cash payment facilities. Although a FSG does not have to be given for advice on these classes of products (see section 941C (6)), the identity of the providing entity must be disclosed under section 941C (7).

This could be addressed by a new Regulation along the following lines:

> *"For paragraph 941C (7) of the Act, the information required to be given does not have to include the information under 942C (2) (a) of the Act in respect of an individual or body corporate that is an authorised representative, if*
>
> - *the financial service is a dealing in a financial product or the provision of financial advice or both, and*
>
> - *the individual or body corporate authorised representative provides the financial service in accordance with the authorisation; and*
>
> - *the licensee has reasonable grounds to believe that the identity or remuneration of the individual or body corporate authorised representative would not be material to a decision by a retail client whether or not to obtain the financial service, and*

- *the identity and contact details of the licensee are provided."*

The ABA raises these matters for the Committee's consideration and favourable recommendation

Draft Regulations-Corporations Amendment Regulations 2004 (Batch 8)

The ABA has supported improved disclosure to consumers to assist them to "shop around" and compare financial products. Disclosure of amounts in a Statement of Advice (SOA), a Product Disclosure Statement (PDS) and a Periodic Statement (PS) as dollar amounts could be desirable in some instances. However, the ABA submits that the imposition of a universal obligation regardless of scale, cost and workability would be inconsistent with Parliament's objective for the financial services regime to improve efficiency in the financial services sector.. To state this more simply, there is a balance needed between these two objectives neither of which is absolute.

The Batch 8 draft regulations suggest that to achieve this goal dollar amount disclosure must be made unless:

> *"… ASIC determines that, for a compelling reason, it is not possible to state the amount in dollar terms…".*

The ABA has discussed the proposed test with ASIC. The ABA understands that ASIC would interpret the test literally. That would mean that unless it is impossible to disclose an amount in dollars the disclosure must be in dollars. ASIC would also need to be involved in a decision as to whether the benefit is possible to be disclosed in a dollar amount, with the added requirement of having a compelling reason for making that decision.

The source of the test appears to have been a note circulated to the Senate by Mr Ian Johnston, Executive Director, Financial Services Regulation, ASIC on 4 December 2003.

The Senate Hansard records Mr Johnston's note as stating:

> *"Our starting point would be that the law requires dollar disclosure unless compelling reasons are provided as to why this could not be achieved".*

Later in the Hansard of 4 December (page 19349) MR Johnston is quoted as stating in the note:

> *"Has ASIC given evidence before the Committee, that evidence would have been that we would require the issuer of a Periodic Statement to make disclosure in dollar terms unless the issuer was able to provide compelling reasons as to why this was not reasonably practicable" (ABA's emphasis).*

It is the ABA's contention that Mr Johnston was not stating when he wrote *"as to why this could not be achieved"* that dollar disclosure must be impossible before a licensee is not required to make dollar disclosure. Looking overall at Mr Johnston's statements it is contended that ASIC would require compelling evidence before it considered that it was not reasonably practicable to make dollar disclosure. The ABA recommends that to make the disclosure in dollars also depends upon whether that amount is readily quantifiable, rather than whether or not it is possible. The "readily quantifiable" test takes into account factors other than mere possibility, such as cost, effort and effect.

For example, the tax benefit a farm management deposit account holder obtains from holding the account is significant because it is the purpose of the account to provide a significant tax benefit. It would be extremely difficult to quantify the benefit as the value of the benefit depends on when the customer wishes to withdraw money from the account. To estimate the value of the benefit would be likely to be mislead the account holder. There are other examples of significant benefits of a financial product that do not readily translate into dollar terms such as the flexibility to be able to transact on the account 24 hours a day 7 days a week at a variety of access points. The current test in Batch 8 would require ASIC to determine that in this instance there is a compelling reason not to disclose the benefit in a dollar amount because it is not possible to do so. It is unclear from the wording in Batch 8 whether ASIC needs to determine this through policy, guidelines or individual relief.

The ABA's recommended approach is consistent with the balance between the consumer benefit and efficiency principles that underpin the financial services legislation. The ABA supports this approach and for the approach to be reflected in the regulations for this purpose.

It is unfortunate that there was not the opportunity for the Parliament to draw Mr Johnston out on the evidence that he said ASIC might have given in this instance to clarify the point.

The Batch 8 draft regulations now leave ASIC with a very inflexible test that (short of outright impossibility in which case ASIC must determine that dollar disclosure is not required) every disclosure must be in dollar terms. This test ignores the costs involved in implementing systems to achieve this result, the time it would take to implement changes to systems. In addition the test would increase the lead-time required to bring new products to the market (thereby having an impact on competition and consumer choice) and the administrative burden placed on ASIC to make determinations regarding the impossibility of dollar disclosure.

The dollar disclosure test could also result in adverse competition effects for smaller financial services licensees. For smaller organisations the economies of scale will be far less than for larger organisations so while implementation might be possible (in

the literal sense) it would be extremely costly relative to larger organisations, disruptive and damaging to their businesses and hence their capacity to compete and provide high quality services to consumers.

For many financial products dollar disclosure would necessitate individualised PDSs because some of the information that would need to be included would not be known until the time the product was due to issue to the client. This would place very onerous systems, procedural and administrative implications and costs on the product provider. For example, for larger organisations retaining control over the quality and compliance aspects of a disclosure document that would be subject to version changes for each client poses a real compliance risk. Also, every PDS would have to be kept for 7 years after being brought into use. This would require sophisticated documentary retention systems to be developed and implemented. These requirements would add greatly to the costs of compliance in addition to the costs of converting systems to enable dollar disclosure.

If it is intended that ASIC would apply the test by assessing every form of SOA, PDS and PS provided by every licensee, we imagine the administrative burden on ASIC to do this even by 1 July 2004 would be virtually impossible without ASIC very substantially augmenting its resources and diverting resources away from other projects and regulatory activities.

However, if there were power for ASIC to deal with applications for relief based on whatever the legislated test provides by ay of class order relief this would help to expedite the administration of applications and provide the much needed certainty to relevant organisations.

Preliminary assessments by ABA members have indicated the need for very substantial systems modifications to develop dollar disclosure models where the relevant factors for calculating dollar amounts are known. Apart from the costs of these changes, the time available is such that it would be virtually impossible to make these changes before 1 July 2004. The ABA recommends an extended transition period to 30 June 2005.

Unless the dollar disclosure test proposed in the Batch 8 regulations is modified there will be, in the ABA's submission, costs, disruptions and market implications that will far exceed the benefit intended to be conferred on consumers.

To assist the Committee, the ABA has received some examples from its members that demonstrate some of the impracticabilities of attempting to make disclosures in dollar terms. The examples appear in the Schedule below.

Concluding Submissions

The ABA submits that to achieve what it believes is a workable and balanced outcome to deliver appropriate dollar disclosure to consumers the following measures are required:

1. The proposed test in the Batch 8 draft regulations should be changed to what the ABA submits is the real import of Mr Johnston's statement to the Senate; that is that a SOA, PDS and PS should disclose in dollar terms the relevant matters set out in the Batch 8 draft regulations unless "ASIC determines that, for a compelling reason, it is not reasonably practicable" for the information to be disclosed in dollar terms and that the amount intended to be disclosed can be readily quantified.

2. Clarification of ASIC's role in the determination of whether a dollar amount is required to be disclosed. For example, ASIC should consult with industry to develop clear guidance on what ASIC considers are "compelling reasons". This could include identifying criteria that would help licensees proceed with certainty in complying with proposed requirements. Alternatively, guidance should be provided through the regulations to assist industry to implement their sign off and compliance programs.

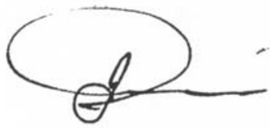
3. The timetable for licensees to develop their systems, procedures and staff training should be developed by ASIC in consultation with the industry and extended beyond 1 July 2004 to 30 June 2005 to enable these changes to be implemented progressively and in an orderly manner.

4. ASIC should monitor developments and progress on implementation of these changes and report periodically to the Committee accordingly.

5. In the event that intractable or unforeseen difficulties arise in industry's implementation of dollar disclosure, a mechanism is available to speedily consider and address these difficulties.

Please contact Ian Gilbert, Director Regulatory Policy, Australian Banker's Association on (02) 8298 0406 in need.

Yours sincerely,



Ian Gilbert
Director

SCHEDULE

1. Dollar Disclosure on PDS and generally

Sub-sections 1013D (1) (b), (d) and (e) require the PDS to disclose significant benefits of a financial product, costs of the product, amounts to be payable in the future by the holder and the return generated for the holder. These will be required to be disclosed in dollars unless ASIC is satisfied otherwise. The following illustrates where these disclosures in dollars cannot be shown. Applying to ASIC for determination of compelling reason for every affected PDS would be administratively impractical for both issuer and ASIC.

a) Interest on "at call" facilities

It is common practice within the finance industry to convey the interest being paid or charged on a financial product in the form of a percentage rate. This is also a practice which customers are familiar with and understand. As interest is a function of both the amount of money invested and the time over which it is invested, it is not possible to disclose interest as a dollar figure due to the variability of these two factors.

The disclosure then would be the applicable percentage rate to be applied to the amount invested from time to time.

b) Fixed Term Investments - Prepayment Interest Adjustment

Where customers request the withdrawal of money from a fixed term investment, such as term deposit, prior to the end of the contracted term, an interest adjustment is calculated and applied to the investment. The adjustment takes into account the length of time the money was invested relative to the contracted term, and applies a percentage adjustment to the interest rate based on this result. Given this adjustment is a function of the amount of money and more particularly time where the time factor will not be known from the outset it is not possible to disclose this as a dollar figure.

The disclosure then would be the calculation method and a worked example.

c) PDS disclosure for investment based products

The majority of fees for managed investment and superannuation products are based on a percentage of the investor's investment balance. For example they may pay an entry fee of up to 4% of the amount invested and a management fee of say 2% of the investment amount. There is no way to disclose the exact dollar amount an investor

will pay because it is not known how much the investor is going to invest. The only way to disclose these fees in dollar terms is to provide an example assuming certain investment balances (eg. if you invest $1000 and the management fee is 2% you will pay $20 per year in management fees). An investor's fund balance may be nothing like the worked example amount and will fluctuate over the life of the investment.

Disclosure as a percentage is actually the clearest and most concise factor for comparisons on this type of product.

d) Percentage based Fees

Some fees are based as a percentage of a variable amount which cannot be predicted at the time the PDS is issued. For example, the service fee on an overdrawn cheque account may be a percentage of the amount overdrawn.

The disclosure would then be the percentage for calculating the fee together with a worked example.

e) Percentage based Commission

Some products are sold or sourced through third party providers who receive a commission payment for performing these services. Depending upon the product, this payment may be either a fixed dollar figure (generally for at-call/transaction based products), or a percentage rate margin (generally for fixed term products). With reference to the percentage rate margin, this is calculated by reference to the amount of money invested and is used to more appropriately reflect the dollar value of the business being generated (i.e. as opposed to a fixed dollar amount). The dollar value of this figure is based on a combination of the commission percentage rate and the dollar amount being invested by the customer. This will vary between investments so as to be unique to each investment and a fixed dollar disclosure would not be possible.

The disclosure should then be the calculation method together with a worked example.