# CHAPTER 8

# Licensing and related issues

## Corporate Superannuation Funds

8.1 Regulation 7.6.01(1)(a) exempts 'dealing' in a financial product by a person in the capacity of a trustee of a superannuation entity (other than the trustee of a public offer entity) from the requirement to hold an Australian financial services licence (a licence). However, there is no such exemption from the licensing requirement for the provision of financial product advice.

8.2 The Corporate Superannuation Association Inc (CSA) raised concerns that employer sponsors and trustees of employer-sponsored not-for-profit funds did not know whether or not they had to be licensed to continue their activities.[1] In this regard, the CSA commented that the difficulties were caused by the uncertainty surrounding the definition of 'financial product advice'. The CSA claimed that its members only supplied fund members with factual information—not financial product advice—and were therefore outside the scope of the regulatory regime. The CSA indicated that ASIC did not share these views.[2]

The Committee's views

8.3 In the Committee's *Report on the Financial Services Reform Bill 2001*, the comment was made that a board trustee or fund representative of a corporate or industry fund should be adequately qualified to give financial product advice. The difficulties involved in determining what was, in fact, financial product advice as distinguished from factual information, were not debated during the course of that earlier inquiry as it was thought the legislation would resolve such issues.

8.4 Furthermore, the situation regarding the licensing of corporate and industry funds had been examined only in the broader context of proposed choice of fund legislation.

8.5 At the Committee's hearing on 27 June 2001, the Department of the Treasury advised that the coverage of superannuation funds under the legislation was dependent on choice of fund legislation. The Department further advised that the intention was to subject only those funds involving choice to the licensing provisions.[3]

8.6 The Committee notes that, since the previous inquiry, some concessions were made for superannuation funds. In particular, regulation 7.6.01(1)(i) allowed for a

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1 Submission 29, p. 4.

2 *Committee Hansard,* 11 July 2002, p. 155.

3 *Committee Hansard,* 27 June 2001, pp. 272–73.

licensing exemption for the provision of 'factual information' to prospective members or members of a superannuation fund. This regulation was later repealed, according to the Explanatory Statement because:

> This exemption is considered to be of uncertain application as the important term 'factual information' is not defined…
>
> It is considered more desirable to remove this exemption and allow the Australian Securities and Investments Commission to determine what particular circumstances the provision of purely factual information should not be considered as a financial service.[4]

8.7 The application of the exemption to superannuation products and retirement savings accounts was also considered inappropriate.

8.8 ASIC has sought to clarify the meaning of factual information in its publication, *ASIC's guide: Licensing: The scope of the licensing regime: Financial product advice and dealing*. Notwithstanding ASIC's guidance, it became evident during the course of the inquiry, that this issue continues to generate significant uncertainty.[5]

8.9 The Committee accepts the evidence from the CSA that the uncertainty regarding licensing is creating substantial operational difficulties for its members. Although the Committee had expected that licensing questions regarding corporate and industry funds would be resolved relatively promptly following its inquiry into the Financial Services Reform Bill in 2001, for various reasons, this has not occurred.

8.10 The Committee considers that the uncertainty with regard to licensing for corporate and industry funds is unacceptable and should be resolved urgently. However, the Committee recognises that the challenges involved in clarifying when these funds should be regarded as providing factual information as opposed to financial product advice are considerable. This is all the more so given that some of these funds offer choice of investment options.

8.11 In view of the complexities involved, the Committee is reluctant to recommend that the uncertainty be resolved through any particular legislative intervention.

**Recommendation**

**The Committee recommends that the Department of the Treasury and ASIC consult urgently with relevant stakeholders to determine how the licensing uncertainties for corporate and industry superannuation funds can be resolved most effectively.**

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4 Corporations Amendment Regulations 2002 (No. 4) SR 2002 No. 319, Explanatory Statement, issued by the authority of the Minister for Financial Services and Regulation, p. 2.

5 See, for example, the discussion on this issue in Chapter 4.

8.12 In commending this course, the Committee is aware of the recommendations of the Productivity Commission in its recent review of superannuation legislation that trustees of superannuation funds should be licensed by APRA as well as by ASIC[6] and the similar draft recommendations favouring dual licensing made by the Superannuation Working Group (SWG).[7]

8.13 The Committee also notes the draft proposal by the SWG that the current 'dealing' exemption applying to public offer funds be reviewed or otherwise that appropriate compensation arrangements should be required as a condition of APRA licensing.

8.14 In this context, the Committee is less inclined to support the 'watering down' of licensing requirements under the FSR regime. Furthermore, the Committee does not consider its current inquiry has been of sufficient scope to enable it to make specific proposals for legislative amendment regarding superannuation licensing issues.

## The Superannuation Complaints Tribunal

8.15 Under the *Financial Services Reform Act 2001* (FSR Act), a licensee must have an internal dispute resolution procedure and also belong to an external dispute resolution (EDR) scheme that is approved by ASIC and:

> …covers…complaints (other than complaints that may be dealt with by the Superannuation Complaints Tribunal…) against the licensee made by retail clients in connection with the provision of all financial services covered by the licensee.[8]

8.16 If the Superannuation Complaints Tribunal (SCT) does not have the jurisdiction to deal with all consumer complaints arising from a licensee's licensed activities, the licensee must ensure that it belongs to an EDR scheme that either deals with all the complaints or those not handled by the SCT.

8.17 In its submission, the Association of Superannuation Funds of Australia Limited (ASFA) referred to the uncertainty surrounding the jurisdiction of the SCT. In particular, it stated that:

> Neither ASIC nor Treasury have provided any clear and detailed enunciation as to their understanding of the limits of the SCT's jurisdiction

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6 *Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation*, Productivity Commission Inquiry Report No. 18, 10 December 2001.

7 *Options for Improving the Safety of Superannuation, Draft Recommendations of the Superannuation Working Group,* 4 March 2002.

8 Subsections 912A(2) and 1017G of the FSR Act. The quote is taken from subparagraph 912A(2)(b)(ii).

> and how this might impact on licensing and the possible need for a superannuation fund to join another EDR.[9]

8.18 While ASIC's Policy Statement 165: *Licensing: Internal and external dispute resolution* (PS 165), states that the SCT might be able to deal with all retail consumer complaints about the financial services provided by certain entities, it also alludes to the possibility that some complaints might not fall within its jurisdiction. The nature of these complaints is not specified.[10]

8.19 ASFA argued that, to avoid confusion, the SCT should have the jurisdiction to deal with all retail consumer complaints. In this regard, Dr Michaela Anderson, Director of Policy & Research at ASFA, stated at the hearing that:

> We really think there is a need for a one-stop shop so that people do not have to deal with trustees in two different dispute mechanisms.[11]

8.20 In addition, ASFA commented that superannuation funds already paid for the SCT through APRA-ASIC levies and argued that, if funds were required to join other EDR schemes, this would add to costs.

The Committee's views

8.21 The Committee accepts ASFA's evidence that uncertainty regarding the jurisdiction of the SCT is causing problems for its member funds. The Committee also agrees with ASFA that it would assist consumers if entities relying on the SCT for the external resolution of disputes did not have to belong to other EDR schemes as a result of limits in the SCT's jurisdiction.

8.22 However, in saying this, the Committee believes that one EDR scheme—whether the SCT or an ASIC-approved scheme—would be preferable to more than one as appears to be the case now.

8.23 The Productivity Commission considered external dispute resolution issues in its superannuation review. It came to the conclusion that there was not sufficient justification for the continuation of the SCT. In coming to this conclusion, the Commission noted that the SCT and industry-based dispute resolution schemes shared many features in common. The fact that the SCT was not constrained by any monetary limits on the complaints within its jurisdiction was viewed as a plus.

8.24 However, the Commission considered that industry-based schemes operated more efficiently and would provide an incentive for industry members to resolve complaints internally or at an earlier stage during external resolution. On this latter point, the Commission said that:

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9 Submission 5, p. 8.

10 See paragraphs PS 165.72 and 165.73.

11 C*ommittee Hansard,* 23 May 2002, p. 12.

> In addition to annual fees, industry-based schemes (unlike the Tribunal) charge their members according to the number and complexity of complaints handled…It could be expected that such a system would result in increased efficiency in processing complaints…It creates a strong incentive for industry members to resolve complaints internally or in the early stages…[12]

8.25 As with its comments about licensing of corporate superannuation funds, the Committee does not believe the scope of this inquiry has provided it with a sufficient basis to make recommendations about EDR schemes vis-à-vis the SCT generally. However, the Committee considers it highly desirable that uncertainty regarding the SCT's jurisdiction be settled if such is feasible.

**Recommendation**

**The Committee recommends that the Department of the Treasury examine relevant legislation to determine whether the scope of the SCT's jurisdiction can be clearly delineated and, if so, this should be done for the benefit of the superannuation industry.**

## Custodial and depository services

8.26 Under the FSR regime, persons providing custodial or depository services have to be licensed. Section 766E defines what constitutes the provision of a custodial or depository service and provides that conduct prescribed by the regulations is exempted from the definition.

8.27 Perpetual Trustees Australia Limited (PTAL)[13] and Trustees Corporations Association of Australia (TCAA)[14] submitted that the definition of what constituted the provision of 'custodial or depository services' was so wide that it covered a range of traditional or personal trustee corporation activities otherwise regulated under State or Territory legislation.

8.28 They argued that regulation of these trusts under the FSR Act was inappropriate and often inconsistent with their purpose—for example, where a trustee might be a guardian or a financial manager appointed by the court to look after the interests of minors or the disabled.

8.29 The PTAL listed several other activities which it argued should be exempted from the definition including:

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12 *Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation*, Productivity Commission Inquiry Report No. 18, 10 December 2001, p. 196.

13 Submission 6.

14 Submission 32.

- the holding of shares or options to subscribe for shares as a trustee of an employee share scheme by an employer or related body corporate of an employer;
- holding a financial product on trust for debenture holders; and
- holding in escrow certificates for restricted securities under the listing rules of a licensed financial market.[15]

The Committee's view

8.30 The Committee accepts the evidence of the PTAL and TCAA that section 766E casts a much wider regulatory net than is necessary.

**Recommendation**

**The Committee recommends that the Department of the Treasury make regulations to refine the scope of the definition of custodial and depository services.**

## Spread betting

8.31 During the course of this inquiry, the Committee became aware that IG Index plc obtained an Australian financial services licence to deal in and give advice on a financial product, specifically a derivative as the term is defined in the Act, but colloquially referred to as spread betting.

8.32 The Committee's inquiries reveal that spread betting is a form of high-risk gambling where losses are potentially open-ended. Because of this and some of the marketing approaches employed by IG Index, the Committee is particularly concerned about the consumer-protection issues involved.

8.33 The Committee believes it would be a travesty if the FSR Act, which is intended to enhance investor protection, actually opens the door to greater risk.

8.34 IG Index made a submission to this inquiry indicating that it had undergone a rigorous licensing process over four months and strongly opposed any move to revoke its licence. It claimed that to do so, among other things, would reflect poorly on Australia as an international financial centre.[16]

8.35 At the hearing on 7 August 2002, Mr Ian Johnston, Executive Director, Financial Services Regulation at ASIC, stated that ASIC had no discretion as to whether or not to issue a licence if an applicant met all licensing requirements.

8.36 With regard to IG Index's application, Mr Johnston advised that:

- all licensing requirements were met;

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15 Submission 6, p. 3.

16 Submission 37.

- IG Index was similarly licensed and authorised by the Financial Services Authority (FSA) in the United Kingdom;
- the FSA had indicated to ASIC that they had no concerns as to the question of whether the applicants were fit and proper persons to meet the licensing requirements; and
- the licence issued to IG Index only covered spread betting on financial indices and not other forms of spread betting.

8.37 Mr Johnston further advised that:

> We are not advocating this as a product—far from it—but it is covered by the definition. They did apply for a licence, they met the requirements, and we issued a licence…
>
> I think it becomes a matter for government—for the appropriateness of that type of product to be considered.[17]

8.38 ASIC also indicated that, although IG Index held a financial services licence in respect of its spread betting activities, this did not necessarily quarantine it from State gaming and wagering laws.

8.39 The Department of the Treasury advised that the Department was investigating the implications arising from the fact that spread betting was a derivative under the Act. Mr Ray, Acting Executive Director, Markets Group at Treasury, commented that:

> …this product meets the definition of financial product in the Act and that is why they have been issued with an AFSL, that section 1101I of the Corporations Act does provide that a contract that is a financial product may be entered into and is valid and enforceable despite any state or territory law relating to gambling or wagering…But that does not mean that the state and territory gaming laws would not be applicable…
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> …The other comment I would make is that at Commonwealth level obviously there is a question about what the policy should be. But before that stage, there are several regulators involved, one of which is ASIC and the other obvious one is the tax office. We are consulting with them on what the situation is before we can form a view to put to government.[18]

8.40 The Chairman of the Committee has discussed this issue with various State gaming authorities, other financial services providers and the Australian Bookmakers' Association, who have all indicated concern about the advent of spread betting.

8.41 Because of the dangers associated with its potentially open-ended nature, bookmakers have not sought previously to have spread betting licensed.

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17 *Committee Hansard,* 7 August 2002, p. 283.

18 *Committee Hansard,* 7 August 2002, p. 265.

8.42 Gaming authorities generally have not issued such licences to other gaming service providers. Indeed, the South Australian authority recently refused to licence a spread betting operation in relation to the 2002 Commonwealth Games.

8.43 State Authorities have advised that it is illegal to advertise betting without a licence as IG Index has been doing.

8.44 The Committee understands that now having been alerted to the issue, the Minister for Gaming in Victoria, the jurisdiction under which IG Index operates, is investigating the legal situation regarding spread betting.

8.45 Financial service providers have indicated that if the operation of the current licensee is allowed to continue, then they will likewise seek a spread betting licence to maintain their position in the marketplace. This is likely to foster exponential growth in spread betting by consumers, further exacerbating problem gambling in Australia.

8.46 At the hearing on 7 August, 2002, the Committee sought to determine where the market stood in terms of hedging products and asked ASIC:

> Do you either know or perceive whether there is a gap in the marketplace for financial products that provide a facility for genuine investors to hedge their investments where required, which they would normally do through warrants or options or whatever that would give this product any sense of being a genuine financial product for investors rather than, as it seems to be being advertised and I think if you generally look at it, simply a gambling product disguised as a financial product?[19]

8.47 Mr Johnston from ASIC responded:

> I do not think there is a gap in the market, I think the Australian financial services market is diverse. I think that it was made clear in the explanatory memorandum for the FSRA that one of the objectives of the legislation was to encourage innovation and diversity. We do have a diverse market at the moment.[20]

**Recommendation**

**The Committee recommends joint action at Commonwealth and State level to ban spread betting on financial markets. At Commonwealth level, this may require an amendment to the definition of 'derivative'. Such an amendment should not inhibit the capacity to invest in genuine investment products. At the State level, it would require governments to ensure that this activity comes under their definition of gaming and is denied a licence.**

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19 *Committee Hansard,* 7 August 2002, p. 107.

20 *Committee Hansard,* 7 August 2002, p. 107.

**Recommendation**

**The Committee recommends that the Government set up an appropriate mechanism whereby ASIC may refer an application for an Australian financial services licence for a decision regarding whether or not the licence should be granted (providing the applicant meets licensing requirements in all other respects) in circumstances where:**

**a) ASIC has reason to believe that granting the licence would not be consistent with the objects of Chapter 7 of the Corporations Act particularly those relating to the enhancement of consumer protection and confidence; and**

**b) ASIC is satisfied that the applicant otherwise meets or is capable of meeting the requirements in the Corporations Act for granting of the licence.**