CHAPTER 9

Impact on small business

Introduction

9.1 A number of submissions highlighted difficulties small businesses were experiencing in adapting to the financial services reform regime (FSR regime). Some submitters referred to the significant demands placed on their limited resources by the sheer volume of the legislation, and to uncertainty surrounding the interpretation of some key terms and policy statements. There was some opposition to what was considered to be an overly prescriptive approach in ASIC's licensing and training policy statements. There was also the concern that the compliance costs associated with licensing would be substantial. Finally, submissions from an insurance multi-agent and the Association of Financial Advisers claimed that the FSR legislation was causing a devaluation of their businesses and placing them at the mercy of large insurers.

9.2 These issues will be discussed under two headings:

- Small business—general; and
- Small business—insurance multi-agents.

Small business—general

Accountants

9.3 Submissions were received from a number of accounting industry groups and a practitioner principally about how the licensing and training provisions would affect accountants.

9.4 In the course of his appearance at the hearing on 11 July 2002, Mr Peter Davis, an accountant and tax agent with his own business, highlighted the difficulties and expense involved in determining compliance requirements under the new regime. Major concerns were with the uncertainty created by the limited licensing exemption in regulation 7.1.29 (discussed in Chapter 5) and the training requirements under ASIC's Policy Statement 146: *Licensing: Training of financial product advisers* (PS 146).[1]

9.5 In relation to training requirements, Ms Kathy Bowler, Manager, Financial Planning at CPA Australia, advised the Committee at the hearing on 11 July 2002 that, on a costs recovery basis, the organisation had estimated licensing in the financial advisory industry to be in the range of $12,000 to $30,000 per person per

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1 *Committee Hansard*, 11 July 2002, p. 198.

year depending upon the financial services covered.[2] In response to questioning by the Committee, she commented that she disagreed with a statement by ASIC that accountants' licensing costs would be 'minimal'.[3]

9.6 The Taxation Institute of Australia referred to the adverse effect on small suburban practices caused by regulation 7.1.29 and pointed out that these practices managed and administered the vast bulk of the self-managed superannuation funds.[4]

Financial planners

9.7 In its submission and at the hearing on 12 July 2002, the Boutique Financial Planning Principals Group Inc (Boutique Group) commented that the new legislation had generated a significant compliance burden for its small business members that was compounded by the vagueness in which requirements were expressed.

9.8 Mr Bruce Baker, President of the Boutique Group, advised the Committee at the hearing on 12 July 2002 that:

> My business is one of the businesses, obviously, that my association represents. It is a small business. I am the only adviser, I have got two part-time assistants. One has been with me for two years; another, whom we are still training, has been with me for four months. My wife helps with the accounts and administration. To state the bald fact, the compliance burden for small dealers over the last few years has been pretty dramatic.
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> …Now we have got a massive round of new changes here with the FSRA and also the related policy statements.[5]

9.9 The Boutique Group said its major difficulties in this regard were that ASIC's Policy Statement 164: *Licensing: Organisational capacities* really catered more for large businesses and was too vague, and also that the training requirements in PS 146 were too prescriptive.

9.10 However, in the course of his evidence, Mr Baker indicated that his organisation had recently met with Ms Pauline Vamos at ASIC who had provided positive and useful guidance.[6]

9.11 Responses to a survey conducted by the Financial Planning Association of Australia Limited (FPA) indicate that transition may present a barrier to entry for the FPA's smaller dealerships. Of the smaller dealerships that had not made the

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2 *Committee Hansard,* 11 July 2002, p. 175.

3 *Committee Hansard,* 11 July 2002, p. 179. The reference to licensing costs being 'minimal' is contained in a letter dated 5 July 2002 from ASIC to the National Institute of Accountants. The letter was tabled at the hearing.

4 Submission 27, pp. 1–2.

5 *Committee Hansard,* 12 July 2002, p. 241.

6 *Committee Hansard,* 12 July 2002, p. 245.

transition, the FPA commented that the 'overwhelming response' to the FSRA licensing process or with ASIC's role in the process was negative. The FPA referred to the key themes as being:

- A perceived failure to cater for the needs of smaller as opposed to larger-sized licensed dealers both in the requirements for transition and in ASIC's treatment of licensed dealers.
- The volume of work involved militating against making an early transition.
- A perceived lack of flexibility and feedback provided by ASIC in assessing applications.
- A perceived variance in the competencies of ASIC officers assessing applications.

9.12 While some respondents were complimentary of ASIC's assistance, others believed that making the transition involved 'a heavy burden in effort, time and money'. [7]

9.13 Of the dealerships which had made the transition, FPA's findings were that there were significant costs involved despite the streamlining provisions. Problems cited with the process were that streamlining was not as flexible as anticipated. There was a call for ASIC 'to drill down and provide guidance on what is required based on size and scope of business'.

9.14 The FPA said that, although ASIC had joined them in initiatives to address difficulties associated with licensees making the transition, there was still a need for 'the development of industry standards where new obligations have arisen under FSRA'. In relation to small to medium businesses particularly, the FPA has called for the Government to:

- allocate $10 million to assist small to medium businesses in making the transition;
- fund industry-specific educational programs;
- fund the development of industry benchmarks; and
- provide a one-off $2,500 grant to each small to medium business that makes the transition before 30 June 2004.

The Committee's views

9.15 At the hearing on 7 August 2002, the Committee sought ASIC's views about small businesses' claims that the licensing requirements in PS 164 were biased towards larger organisations and did not take into account the more limited resources of small businesses. Mr Ian Johnston, Executive Director, Financial Services Regulation, advised that:

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7 Attachment to letter to the Committee from the FPA dated 24 September 2002—results of survey—*Financial Planning Association of Australia Ltd, Financial Services Reform Act 2001—Transitioning.*

> We have been getting that feedback in parts; I would not say that that was universally the case. We have tried to make it clear in all of our consultations—and these are extensive consultations that we have had with industry—that the whole concept of satisfying ASIC about capabilities and obtaining a licence is a scalable concept. We have heard the sort of comment that you have made. Our experience in licensing so far has meant that we have not really had enough experience of people coming through the door to form a view as to whether some are finding it difficult or not.[8]

9.16 Expanding on Mr Johnston's comments, Mr Malcolm Rodgers, Executive Director, Policy and Markets Regulation, further advised that:

> I will describe…what policy statement 164 is intended to do. It is intended to say, 'When you make an application, here are the things that the law requires you to demonstrate to us and that we have to be satisfied about. Here are the sorts of things that we will think about when we receive an application from you, but we will always bear in mind that these things will vary according to…the nature, scale and complexity of your business…' We are not saying that you must meet a fixed standard which is determined by us, but we have tried to make the doorway to a sensible dialogue with us in the application process as open and as clear as possible.[9]

9.17 The Committee recognises that there may be problems of adjustment associated with the transition to the new regime. It also appreciates that the changes entailed could be felt more keenly by small businesses particularly those that have not been subject to a similar level of regulation before.

9.18 Although FPA's survey corroborates evidence from other associations and individuals about the difficulties involved in making the transition from the old to the new regime, the Committee notes that the FPA's results are based on a 9.8 per cent response rate only.

9.19 The Committee is satisfied that ASIC has gone to some lengths to advise the financial services industry of requirements—through its nationwide educational campaigns, its comprehensive guidance papers and its readiness to consult with industry bodies about their particular concerns. The Committee is also satisfied that ASIC continues to respond to needs as they are identified during the transition period.

9.20 In this regard, the Committee notes ASIC's advice that it plans to issue a series of guides to help particular industries with their licence applications. The first guide, released at the end of August 2002, will provide more tailored assistance to financial advisers.[10]

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8 *Committee Hansard,* 7 August 2002, p. 274.

9 *Committee Hansard,* 7 August 2002, pp. 275–76.

10 *Financial advisers: What type of AFS licence authorisations and assessment process do you need to apply for?* 26 August 2002. See also ASIC Media and information release IR02/13 *A guide to having your AFS application accepted.*

9.21 In September 2002, ASIC also announced an initiative to help 'the small end of town'. This encourages applicants to make the transition early and is intended to provide more individual support to these applicants.

9.22 The Committee believes that ASIC's industry-specific licensing guides, existing policy statements and recent initiatives to assist small businesses are providing responsive support to those involved in the transition. The Committee accepts that these may need further work as problems come to light but is not persuaded that the Committee's intervention would be justified at this stage.

9.23 However, the Committee strongly urges ASIC and the Department of the Treasury to monitor small business during the transition period with a view to providing the necessary legislative or other intervention if such is considered appropriate.

Small business—insurance multi-agents

9.24 In evidence given at the hearing on 23 May 2002 by the Association of Financial Advisers and Mr Michael Murphy, concerns were raised that the new licensing provisions had made it difficult for multi-agent advisers in the life and risk insurance industry to continue their businesses.

9.25 They claimed that the maintenance of multi-agent status did not appear to be an option because of liability issues involved in cross-endorsement. Where multi-agents restructured their businesses to accommodate the new regime, they stated that there would be adverse tax consequences.

9.26 In addition, they were concerned that licensees were unfairly terminating agents' contracts with effect from 30 June 2002 without paying compensation for the resulting loss of commission income. They suggested that the legislation had changed their relationship with their clients with the result that they were deprived of the value of their businesses. They argued that the legislation had disadvantaged them and favoured large corporate licensees who were able to sign up agents as authorised representatives on less attractive terms than existed under the previous arrangements. Furthermore, they claimed that agents were being pressured to make the transition into the new regime without the benefit of the two-year period allowed.[11]

9.27 At the hearing on 11 July 2002, the Committee sought the views of the Financial Planning Association of Australia Limited (FPA) regarding the situation with insurance multi-agents. Mr Breakspear, Chief Executive, commented that the industry was undergoing some restructuring particularly where multi-agents were concerned. He said that because of liability issues, licensees no longer favoured cross-endorsement of representatives' authorities. He indicated that the marketplace was responding by setting up new business structures under which multi-agents could operate. In particular, he said that:

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11 *Committee Hansard*, 23 May 2002, pp. 35–40.

> There are probably three or four different ways a multi-agent can restructure into the new regime. One is to go and find a neutral branded licensee. They can find a branded licensee if they want. They can group together, which a number of them have done, and make an application for a licence. The multi-agent, if they are large enough, may have the resources and the expertise to gain their own licence, and there is provision under legislation for limited licences for a transitional period. They can either continue where they are for two years—that is, have a transitional period; they can go and gain their own licence; they can group together, which a number of them have, with other multi-agents to get some scale to gain a licence; or they can go and align themselves with one of the existing life institutions that they already have. So there is a range of choices.[12]

9.28 At the hearing on 7 August 2002, the Committee sought a response from the Department of the Treasury to the claims raised by multi-agents. In a subsequent letter to the Committee, the Department addressed the multi-agents' claims that the FSR legislation had adversely affected their rights under their agreements with insurance principals and had provided the latter with the opportunity to terminate existing contracts. The Department maintained that:

- the termination of agency agreements could not be attributed to the FSR Act as it did not, of itself, require termination of those agreements, and any effect on them would depend on the terms of the agreements themselves;
- the FSR provisions concerning authorised representatives were broad enough to accommodate existing agreements between principals and life insurance agents under the *Insurance (Agents and Brokers) Act 1984* (IABA) so, arguably, they could continue to operate;
- in this regard, section 1436A was inserted specifically in the FSR Act to provide that insurance agents subject to the IABA could continue to operate under that Act for the full two-year transition period notwithstanding that their principals may have made the transition into the new regime; and
- while licensed principals might have greater responsibility for the actions of their authorised representatives, this did not necessary translate into greater costs in relation to authorised representatives.

9.29 In connection with the last point, the Department commented that:

> …licensed principals may well undertake an examination of the activities of their representatives, and would factor into any contractual negotiations the costs of maintaining the agreement relative to the benefits that the agreement brings.

9.30 At the hearing, the FPA, the Department and ASIC acknowledged that structural change was occurring in the industry.

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12 *Committee Hansard*, 11 July 2002, p. 125.

9.31 ASIC suggested that the concerns raised by multi-agents appeared to have a commercial basis and did not relate to regulatory issues. In response to the Committee's suggestions that the bargaining position of multi-agents may have been adversely effected by the FSR Act, Mr Johnston commented that:

> I think it is too early to say what will happen in the multi-agency environment, but certainly our indications are that there will be reluctance to do 'cross-endorsement'—as it is referred to—and have multiple consents and endorsements.
>
> …But it is too early to say how it will play out.[13]

The Committee's views

9.32 The Committee notes the observations of the FPA, the Department of the Treasury and ASIC that restructuring is occurring in the industry within which multi-agents operate and that this and commercial factors might account for some of the concerns raised by multi-agents. The Committee further notes that the FSR Act applies more stringent liability provisions to licensed principals regarding the conduct of their authorised representatives. In view of evidence provided to the Committee that liability issues have contributed to the loss in favour of cross-endorsements, the Committee considers that this factor lends weight to claims by the multi-agents concerned that their bargaining power has been reduced.

9.33 The Committee accepts the evidence of the Department of the Treasury that there is nothing in the FSR Act itself that requires termination of existing agency contracts. The Committee also notes that provision has been made in the FSR Act to protect the position of multi-agents who wish to take advantage of the full two-year transition period.

9.34 However, while the Committee agrees with the comments of the Department that 'negotiation of agreements and their agents should be a matter for those parties', it nonetheless is concerned that licensed principals may be using the FSR legislation to justify termination of existing contracts when this would otherwise not be occurring.[14]

9.35 The Committee therefore concludes that the amendment in the FSR Act to protect multi-agents' contractual rights is not achieving the intended result.

Recommendation

The Government should amend the FSR legislation urgently to ensure that its detrimental impact on the position of insurance multi-agents is ameliorated and their existing rights preserved. In particular, policy and legislation should provide for:

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13 *Committee Hansard,* 7 August 2002, pp. 277–78.

14 Letter to the Committee from the Department of the Treasury, dated 21 August 2002, p. 2.

- **the protection of multi-agents from arbitrary termination of their rights as multi-agents under contracts entered into under the Corporations Act before the commencement of the FSR legislation;**

- **ways in which the post-FSR trend away from cross-endorsements can be reversed and insurance licensees encouraged to approve cross-endorsements;**

- **the prescription of a reasonable period during which licensees must remit monies (including commissions) owing to insurance multi-agents;**

- **ASIC's exercise of its powers under section 915H of the Corporations Act to protect the position of insurance multi-agents (as authorised representatives) should their licensee's licence be suspended or cancelled;**

- **the development of a mechanism (for example, a trust fund) to protect payments owed to a multi-agent where the multi-agent's principal becomes insolvent or bankrupt or where such is threatened ('the insolvency event') and regardless of whether the payments at the time of the insolvency event:**

    - **are owed directly to the multi-agent by the principal; or**

    - **are payable to the principal by a product provider and in the normal course would be drawn upon wholly or in part for payment by the principal to the multi-agent.**

The Committee recommends legislative intervention to achieve the above objectives. However, where the Department of the Treasury and ASIC are able to facilitate non-legislative initiatives within the relevant insurance industry sector to further the interests of insurance multi-agents, the Committee would strongly encourage this.