Parliament of the Commonwealth of Australia

REPORT ON THE REGULATIONS AND ASIC POLICY STATEMENTS MADE UNDER THE *FINANCIAL SERVICES REFORM ACT 2001*

PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

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DUTIES OF THE COMMITTEE

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the duties of the Committee as follows:

The Parliamentary Committee's duties are:

(a) to inquire into, and report to both Houses on:

(i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

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ACRONYMS AND ABBREVIATIONS

AAMI	Australian Associated Motor Insurers Limited
AAPBS	Australian Association of Permanent Building Societies
ABA	Australian Bankers' Association
ACA	Australian Consumers' Association
ADI	Authorised deposit-taking institution
AFA	Association of Financial Advisers
AFC	Australian Finance Conference
ASFA	The Association of Superannuation Funds of Australia Limited
ASIC	Australian Securities and Investments Commission
BDP	Basic deposit product
Boutique Group	Boutique Financial Planning Principals Group Inc
CPAA	CPA Australia
CP Act	*Financial Services Reform (Consequential Provisions) Act 2001*
CSA	Corporate Superannuation Association Inc
CUSCAL	Credit Union Services Corporation (Australia) Limited
EDR scheme	External dispute resolution scheme
FPA	Financial Planning Association of Australia
FSRA	*Financial Services Reform Act* 2001
IAG	Insurance Australia Group
IABA	*Insurance (Agents and Brokers) Act 1984*
IBSA	International Banks and Securities Association of Australia
ICAA	The Institute of Chartered Accountants in Australia
IFSA	Investment and Financial Services Association
NCP facility	Non-cash payment facility
NTAA	National Tax & Accountants' Association

NIA	National Institute of Accountants
NIBA	National Insurance Brokers' Association of Australia
OMC	Ongoing management charge
PDS	Product Disclosure Statement
PS 146	ASIC Policy Statement 146: Licensing: Training of financial product advisers
PS 164	ASIC Policy Statement 164: Licensing: Organisational capacities
PS 165	ASIC Policy Statement 165: Licensing: Internal and external dispute resolution
PTAL	Perpetual Trustees Australia Limited
SCT	Superannuation Complaints Tribunal
TCAA	Trustees Corporations Association of Australia
TIA	Taxation Institute of Australia
Wallis Inquiry	Financial System Inquiry (Final Report published in March 1997.)

List of Recommendations

Recommendation p. 10

The Committee therefore recommends that the Department of the Treasury conduct the necessary investigations into the problems identified in paragraph 3.6 of Chapter 3, with a view to making the appropriate legislative amendments.

Recommendation p. 25

The Committee, for the third time, recommends that the Government, either by amending the Corporations Act or regulations, should remove basic deposit products and related non-cash payment facilities from the definition of 'financial product'.

Recommendation p. 26

The Committee recommends that ASIC urgently review the training requirements in PS 146 so they take into account the special features of basic deposit products and related non-cash payment facilities.

Recommendation p. 26

In addition, the Committee recommends that ASIC consider amending PS 146, as far as possible—and without compromising consumer protection—to:

- provide a framework for more cost-effective reviews of ADIs' current in-house training requirements;
- ensure training costs—whether in-house or external—are more proportionate to envisaged consumer protection gains; and
- cater for the training challenges presented by agencies and small branches, particularly in regional and remote areas.

Recommendation p. 36

The Committee recommends that the Government amend the Corporations Act or regulation 7.1.29 to provide a licensing exemption for accountants in similar terms to the exemption provided to lawyers in paragraphs 766B(5)(a) and (b) of the Act. The exemption should also make it clear that it will not apply where the exempted activity attracts payment of commission or other benefit from a third party not connected with the client.

Recommendation p. 44

The Committee recommends that:

- ASIC and the Department of the Treasury work together to continue the momentum generated by ASIC's initial investigations into the disclosure of fees and charges for investment products[1] to produce guidelines for a leading-edge, consumer-friendly superannuation fee disclosure model that will facilitate comparability of funds; and
- upon the development of an appropriate disclosure model, ASIC should publish details in a guide for use by the superannuation industry. ASIC should also alert consumers to the advantages of the model and provide working notes.

Recommendation pp. 47-48

The Committee recommends that regulations be made to continue the existing provisions in the *Insurance (Agents and Brokers) Act 1984* with application to wholesale clients in addition to retail clients regarding:

- dealing with unauthorised foreign insurers;
- providing details of the insurer;
- disclosing an association with an insurer; and
- disclosing binder arrangements with insurers.

Recommendation p. 48

The Committee also recommends that ASIC be empowered to collect information about licensees dealing with unauthorised foreign insurers as was the case under the *Insurance (Agents and Brokers) Act 1984*.

Recommendation p. 51

The Committee recommends that regulation 7.6.01(1)(n) be reviewed as soon as possible with the objective of resolving the difficulties involved in its practical application and so make it consistent with the regulatory objective of enhancing efficiency in the provision of financial product

Recommendation p. 54

The Committee urges ASIC to reconsider its timetable with a view to expediting its policy formulation for the regulation of cross-border financial services following the consultation process.

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1 These initial investigations refer to Professor Ramsay's report into fees and charges which ASIC commissioned: *Disclosure of fees and charges in managed investments, review of current Australian requirements and options for reform,* released on 25 September 2002.

Recommendation p. 56

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.

Recommendation p. 59

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.

Recommendation p. 60

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

Recommendation p. 62

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.

Recommendation p. 63

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.

Recommendation pp. 71–72

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:

- 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.

Recommendation p. 76

The Committee recommends that the Government review the telephone monitoring provisions with a view to removing them from the Corporations Act altogether.

CHAPTER 1

Background to the inquiry

1.1 The *Financial Services Reform Act 2001* (the FSR Act) introduced significant reforms into the *Corporations Act 2001* and was passed by Parliament on 28 August 2001. However, it was not until 11 March 2002 that most of the reforms commenced.

1.2 The FSR Act set up an integrated regulatory framework for the financial services industry covering licensing, disclosure and conduct requirements of financial service providers, financial product disclosure arrangements and the licensing of financial markets and clearing and settlement facilities.

1.3 For those financial sector participants affected by the new legislation, the *Financial Services Reform (Consequential Provisions) Act 2001* (the CP Act) set out detailed arrangements for their transition from the old to the new regime. Under the CP Act, participants were generally allowed a maximum of two years to do this.

1.4 The FSR Act was drafted to provide the basic principles for uniform regulation across the financial services sector. It was intended that regulations made under the FSR Act would provide the detail for the practical application of the legislation. In particular, the regulations would allow for flexibility in application where, for example, exemptions from or variations to licensing or disclosure requirements might be appropriate for particular activities or entities.

1.5 In early August 2001, the Department of the Treasury released the first of several tranches of draft regulations that would be refined through public consultation over the ensuing months. These regulations[1] provided much of the machinery for implementation of the new regulatory regime and commenced on 11 March 2002. The Department has continued to make new regulations as areas requiring adjustment are identified.

1.6 The Australian Securities & Investments Commission (ASIC) is the administrator and main regulatory body responsible for implementation of the new regime. Through an extensive consultation process beginning in April 2001, ASIC formulated policy statements and guidance papers to elucidate the general principles under which ASIC proposed to exercise the discretionary powers conferred by the new regime. In tandem with the development of its policy statements, ASIC conducted nationwide 'ASIC Speaks' seminars on the new legislation and placed comprehensive 'Question and Answer' information on its website which continues to be updated.

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1 In consolidated form, the regulations are the Corporations Regulations 2001.

1.7 On 28 November 2001, ASIC released a guidance paper on financial product advice and dealing, and six policy statements concerning licensing, disclosure and transitional arrangements. Further process-related publications were issued over the next few months.

1.8 On 20 March 2002, the Committee resolved to inquire into and report on the Corporations Regulations 2001 (the Corporations Regulations) and ASIC's policy statements to ascertain the extent to which they were consistent with the stated objectives and principles of the FSR Act. The Committee advertised nationally on 6 April 2001 inviting submissions from interested parties.

1.9 Written submissions totalled 40. There were an additional 7 supplementary submissions. A list of these submissions is in Appendix 1 to this report.

1.10 Public hearings were held in Melbourne on 23 May 2002 and in Sydney on 11 and 12 July 2002, and on 7 August 2002. A list of witnesses who appeared before the Committee is in Appendix 2.

1.11 All submissions and the Hansard of the Committee's hearings are tabled with this report. The Hansard of the hearings is available at the Parliamentary website (www.aph.gov.au/hansard/joint/committee/j-corps-fs.htm).

1.12 The Committee acknowledges the assistance of those who made submissions or who appeared as witnesses.

CHAPTER 2

Overview of the Act, regulations and ASIC policy statements

The Financial System Inquiry

2.1 The *Financial Services Reform Act 2001* (FSR Act) was the main piece of legislation in a package of four statutes introduced to reform financial sector regulation.[1]

2.2 It represented the sixth stage of the Corporate Law Economic Reform Program developed in response to the recommendations of the Financial System Inquiry (Wallis Inquiry) released in March 1997.

2.3 The Wallis Inquiry had been established in May 1996 to examine the consequences of financial deregulation in the 1980s and the drivers of further change with a view to formulating regulatory arrangements that would deliver an efficient and cost-effective service for users and encourage innovation and competition.

2.4 In its report, the Wallis Inquiry observed that regulation of the financial services industry was fragmented and complex. There were inconsistencies in licensing requirements for financial service providers in different industry sectors with instances of overlapping and contradictory regulation. There were also inconsistencies in product disclosure requirements and a lack of comparability of product information. Regulation of financial markets under the then Corporations Law was incomplete and inflexible.

2.5 These factors had created inefficiencies for operators, confusion for consumers, and greater costs.

2.6 The Wallis Inquiry proposed a functional approach to regulation and recommended that responsibility for corporations, market integrity and consumer protection be vested in one regulator. These recommendations set processes in train that saw ASIC's establishment in 1998 and the passage of the FSR Act and related legislation in the second half of 2001.

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1 Other Acts in the package were the *Financial Services Reform (Consequential Provisions) Act 2001* which set out the transitional arrangements for the new regulatory regime, the *Corporations (Fees) Amendment Act 2001* and the *Corporations (National Guarantee Fund Levies) Amendment Act 2001*.

The Financial Services Reform Act 2001

2.7 Upon the introduction of the Financial Services Reform Bill 2001 into the Parliament, the then Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, explained that the legislation was designed to:

- provide a harmonised licensing, disclosure and conduct framework for all financial service providers;
- establish a consistent and comparable financial product disclosure regime; and
- create a streamlined regulatory regime for financial markets and clearing and settlement facilities.[2]

2.8 The Explanatory Memorandum to the Bill said that these reforms:

> …will put in place a competitively neutral regulatory system which benefits participants in the industry by providing more uniform regulation, reducing administrative and compliance costs, and removing unnecessary distinctions between products. In addition, it will give consumers a more consistent framework of consumer protection in which to make their financial decisions. The Bill will therefore facilitate innovation and promote business, while at the same time ensuring adequate level of consumer protection and market integrity.[3]

2.9 These features reflected the principles embedded in many of the Wallis Inquiry's recommendations which proposed consistency, flexibility and responsiveness in regulatory arrangements to encourage competition and innovation and also to accommodate future change in the financial system. These goals were to be achieved without unduly compromising consumer protection and market integrity.

2.10 The legislation also contained provisions relating to market misconduct and telephone monitoring during takeover bids, and raised the voting power limit from 5 to 15 per cent for a body corporate (or the holding company of such a body) holding an Australian market licence or an Australian clearing and settlement facility licence.

2.11 The FSR Act represented the culmination of policy formulation and drafting processes involving significant public and industry consultation. The Committee contributed to this process with two inquiries, the first conducted after the Department of the Treasury's release of an exposure draft of the Bill in February 2000 and the second following the Bill's introduction into the Parliament on 5 April 2001.[4] On

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2 Second Reading Speech, 5 April 2001, *House Hansard*, pp. 26 and 521.

3 Financial Services Reform Bill 2001, Explanatory Memorandum, Parliament of the Commonwealth of Australia, House of Representatives, p 1.

4 *Report on the Draft Financial Services Reform Bill, August 2000* and *Report on the Financial Services Reform Bill 2001, August 2001*.

both occasions, the Committee's recommendations were influential in the Bill's development.

2.12 In its second report, the Committee noted that the Bill had been well received by the financial services industry and that, generally, the consultation process had been 'appropriate and effective'.[5] Although some aspects of the Bill were regarded as problematic, this was not considered sufficient to affect its overall acceptance. The Committee recommended that the Bill be passed.

2.13 A number of the Committee's recommendations involved issues that have been raised in the current inquiry. These include concerns about the treatment of certain deposit products offered by ADIs, commission disclosure, the legislation's impact on small business and certain issues relating to Australia as an international financial centre. These and other issues covered by the inquiry will be discussed more fully in the following chapters.

Key elements of the regulatory framework

2.14 The FSR Act replaced Chapters 7 and 8 of the Corporations Act 2001, repealed the Insurance (Agents and Brokers) Act 1984, parts of the Superannuation Industry (Supervision) Act 1998, the Retirement Savings Account Act 1997, the Insurance Act 1973 and the Banking (Foreign Exchange) Regulations. It reformed and consolidated the disparate elements of several regimes into a single, wider-ranging regulatory framework.

2.15 Three interrelated features underpin this regulatory framework. These are briefly described here as they give an insight into the fundamental role played by the regulations and ASIC policy in the overall regulatory scheme.

2.16 The core feature is the concept of the 'financial product'. As the FSR Act is all about regulating conduct in relation to financial products, the definition of this term sets the boundaries of regulation. The term has a functional definition and includes things such as a security, derivative, futures contract, insurance contract, an interest in a managed investment scheme, a bank deposit product and superannuation. There are some definite exclusions from the list and, among these, are health insurance, reinsurance, an interest in a superannuation fund as prescribed by the regulations and credit facilities as defined in the regulations.

2.17 The second feature involves what constitutes conduct in relation to a financial product or, more specifically, the provision of a 'financial service' in the context of carrying on a financial services business. The provision of a financial service can entail giving financial product advice, dealing in a financial product, making a market for a financial product, operating a registered scheme or providing a custodial or depository service. Engaging in any of these activities triggers a licensing

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5 *Report on the Financial Services Reform Bill 2001*, p. 85 (para 6.1).

requirement which itself comes with a range of obligations designed to promote investor confidence and the integrity of the financial system.

2.18 The third feature underpinning the framework refines the boundaries of regulation further and is based on a distinction between 'retail' and 'wholesale' clients. The nature and extent of a licensee's obligations will depend largely on whether the consumer of a financial service is a retail or wholesale client. The distinction is important because most of the consumer-protection and disclosure standards apply only to retail clients, the assumption being that wholesale investors, by virtue of their knowledge and experience, do not need the same level of protection as retail investors.

2.19 Generally, an investor is a retail client according to the value of the financial service provided. An investor is a wholesale client where the financial product or service is used in connection with a business or otherwise where the investor has net assets or a gross annual income meeting certain levels. The definition relies on regulations to prescribe values and calculation methods.

2.20 The definitions and sub-definitions of the three key features come with regulation-making powers and discretionary powers exercisable by ASIC which can extend or modify their application.

The regulations and ASIC policy statements

2.21 The regulations and ASIC's discretionary powers are a central feature of the new regime. Besides making the legislation more flexible, they 'flesh out' the detail needed for implementation of the principles embodied in the FSR Act which is why they were timed to commence at the same time as the FSR Act.

2.22 The Explanatory Statement to the regulations leaves their importance to the regime's efficacy in no doubt.[6] It says that the regulations are intended to:

> …provide detailed requirements—for example, the procedure for transferring securities, the matters which must be addressed in an application for a licence and the requirements for disclosure by the issuer of a superannuation product;
>
> …provide for exemptions from the requirements of the Act (or for modified application) where the impact is inappropriate …
>
> …assist in the transition to the new regime; and
>
> …make consequential and miscellaneous amendments.[7]

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6 Corporations Amendment Regulations 2001 (No. 4) SR 2001 No. 319 made on 8 October 2001. These were followed by the Corporations Amendment Regulations 2002 (No. 2) SR 2002 No. 16, Corporations Amendment Regulations 2002 (No. 3) SR 2002 No. 41 and Corporations Amendment Regulations 2002 (No 4) SR 2002 No. 53. All had a commencement date of 11 March 2002.

2.23 Given these rather wide-ranging objectives, it is perhaps not surprising that the regulations are extensive and complex.

2.24 As with the regulation-making powers, the FSR Act provides considerable scope for ASIC's exercise of discretionary powers. These powers find expression, among other things, in ASIC's policy statements which give detailed guidance on how ASIC will administer the laws for which it is responsible. During the lead-up to the commencement of the new regime, ASIC released policy statements and guidance notes on a range of matters, most notably, those concerning licensing, disclosure and transitional matters.

2.25 At the Committee's hearing on 23 May 2002, Mr Ian Johnston, Executive Director, Financial Services Regulation at ASIC, commented that:

> …a policy statement is guidance that ASIC issues. It gives an indication to the marketplace as to how ASIC will interpret the law and how we will apply the law—but it does not have the force of law.[8]

2.26 In its August 2001 report on the Financial Services Reform Bill, the Committee recognised the key role played by the regulations and ASIC's policy statements, and concluded 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.
>
> …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.[9]

2.27 The consultation process for the regulations and ASIC policy statements was conducted within a relatively tight timeframe following the introduction of the FSR Act into Parliament.

2.28 As the implementation of the new regime depends largely on the regulations and ASIC's exercise of its discretionary powers, it is important that these mechanisms remain faithful to the objects of, and the principles embodied in, the legislation.

2.29 The main principles upon which the new regime is founded—outlined previously—complement the main object of the FSR Act which is to promote:

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7 Corporations Amendment Regulations 2001 (No 4) SR 2001 No. 319, Explanatory Statement, issued by the authority of the Minister for Financial Services and Regulation, p. 1.

8 *Committee Hansard*, 23 May 2002, p. 66.

9 *Report on the Financial Services Reform Bill*, p. 85.

a) confident and informed decision making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services;

b) fairness, honesty and professionalism by those who provide financial services;

c) fair, orderly and transparent markets for financial products; and

d) the reduction of systemic risk and the provision of fair and effective services by clearing and settlement facilities.[10]

2.30 The current inquiry seeks to examine the regulations and ASIC policy statements to determine whether or not they are consistent with the legislation's objects and principles. The remainder of this report will discuss the inquiry's findings.

10 Section 760A.

CHAPTER 3

Overview of submissions

1.1 The terms of reference for this inquiry, namely, to ascertain the extent to which the regulations and ASIC policy statements are consistent with the objectives and principles of the *Financial Services Reform Act 2001* (FSR Act), are broadly framed.

1.2 It is consequently not surprising that issues raised in evidence covered a wide range of concerns.

1.3 Several issues were outside this inquiry's terms of reference because they related only to provisions in the *Corporations Act 2001* (the Corporations Act) and had no nexus with the regulations or ASIC's policy statements. A number of the more complex issues are listed at the end of this report.

1.4 The main concerns raised within the inquiry's terms of reference generally fell into three categories.

1.5 The first category related to less complex drafting inconsistencies between provisions in the Corporations Act and the regulations. The Committee understands that the Department of the Treasury is addressing these types of concerns as they are identified.

1.6 The second category pointed to more substantive difficulties arising from the regulations including:

a) inconsistencies in the interaction between subsection 1017F(6) and regulation 7.9.61D regarding standing facilities and the confirmation of transactions;

b) the absence of a definition of 'eligible successor fund' in regulation 7.9.61D;

c) uncertainty about the ambit of regulation 7.9.62 and whether the exemptions it provided allowed for the crediting of negative interest in some circumstances without requiring confirmation under section 1017F;

d) whether it was appropriate that the allocation prices—as opposed to the redemption price—of an interest in a managed investment should be paid to a 'cooling off' investor under regulation 7.9.67; and

e) whether it was appropriate that regulation 7.9.68 should deem an employer-sponsor to be a client for the purposes of 1019A(3).

1.7 The Committee accepts that these concerns require further examination. However, as they generally involve technical drafting issues or otherwise policy matters which are somewhat confined in their scope, the Committee considers it would be more appropriate for the Department of the Treasury to investigate these.

Recommendation

The Committee therefore recommends that the Department of the Treasury conduct the necessary investigations into the problems identified in paragraph 3.6 above, with a view to making the appropriate legislative amendments.

1.8 Finally, the third category comprised concerns appearing to represent more serious departures from the Corporations Act's principles and objectives. These included, for example, issues relating to:

a) ASIC's training requirements in Policy Statement 146: *Licensing: Training of financial product advisers* as they apply to front-counter representatives of authorised deposit-taking institutions (ADIs);

b) the licensing of accountants and regulation 7.1.29;

c) Schedule 10B of the regulations and disclosure requirements regarding the ongoing management charge (for superannuation funds);

d) ASIC's licensing requirements, particularly in Policy Statement 164: *Licensing: Organisational capacities* and Policy Statement 165: *Licensing: Internal and external dispute resolution*, and the impact on small business;

e) regulation 7.6.01(n) and the restriction of the licensing exemption for offshore service providers to 'dealing'; and

f) ASIC's approach to its assessment of overseas regulatory authorities to accommodate the provision of financial services to wholesale clients by offshore providers.

1.9 The Committee believes these issues must be addressed because of their potentially substantial impact on the financial services industry generally or on large sectors within the industry. In several cases particularly, licensing and disclosure concerns were raised that the Committee considers require urgent resolution. The focus of the Committee's inquiry has consequently been on these issues. The Committee's findings are discussed in the following chapters.

1.10 In addition, the Committee touched on two matters not strictly within its terms of reference. The first relates to the impact of the FSR legislation on small business, particularly in the context of the operations of insurance multi-agents. The Committee examined small business issues at its two earlier inquiries into financial services reform and is concerned that these issues are still being raised.

The second matter concerns whether it is appropriate for the FSR regime to accommodate the licensing of persons to deal in and advise on spread betting activities. The Committee believes the issues involving this matter call into question whether the FSR Act is meeting its consumer protection objectives.

CHAPTER 4

ASIC Policy Statement 146: Licensing: Training of financial product advisers

Introduction

4.1 Before granting a licence ASIC must be satisfied, among other things, that an applicant will be able to comply with its statutory obligations, including those relating to training and competency.[1]

4.2 ASIC's Policy Statement 146: *Licensing: Training of financial product advisers* (PS 146) sets out minimum training standards for people who provide financial product advice to retail clients.[2] The training standards apply to the provision of both personal and general financial product advice.

4.3 Several submissions from authorised deposit-taking institutions (ADIs) or from industry groups representing ADIs were highly critical of the training requirements prescribed by PS 146 for advisers on basic deposit products (BDPs) and related non-cash payment (NCP) facilities. They argued that the requirements were excessive and costly, and questioned whether, in fact, they would deliver any benefits to consumers. In addition, they claimed that the delivery of services in remote and regional areas would be threatened.

4.4 Apart from the criticisms targeted at training requirements for BDPs, relatively few submissions raised concerns about other requirements in PS 146.

4.5 Of these, the Insurance Australia Group (IAG)[3] claimed the training requirements for advisers on personal accident and sickness insurance products were excessive, while the National Institute of Accountants (NIA) considered that PS 146 failed to recognise accountants' professional qualifications where financial planning advice was dispensed.[4]

4.6 In addition, the requirement in PS 146 that advisers must have 5 years' relevant experience in the previous 8 years to qualify for individual assessment, attracted comment from Freehills[5] and the Australian Associated Motor Insurers

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1 Paragraph 913B(1)(b) of the *Financial Services Reform Act 2001*.

2 Under subsection 766B(1) of the *Corporations Act 2001*, 'financial product advice' is a recommendation or statement of opinion or a report of either that is intended to influence or could reasonably be regarded as intended to influence a person in making a decision in relation to a particular financial product or class of financial products. For clarification of the definition, ASIC has released *Licensing: The scope of the licensing regime: Financial product advice and dealing—an ASIC guide*, November 2001.

3 Submission 28.

4 Submission 16 and supplementary submission 16A.

5 Submission 7 and supplementary submissions 7A and 7B.

Limited (AAMI).[6] The general view was that there should not be a threshold for this type of assessment.

4.7 These issues will be discussed in more detail in this chapter.

PS 146 requirements in brief

4.8 ASIC states in PS 146 that the training focus is 'on protecting retail clients because they generally do not have the resources or expertise to assess whether their adviser has an appropriate level of competency to provide financial advice'.[7]

4.9 The policy statement recognises formal qualifications or experience according to the type of financial product advised on. Two levels have been developed:

- Tier 1, the higher level, which is broadly equivalent to the 'Diploma' level under the Australian Quality Training Framework (AQTF) and applies to all financial products not listed in Tier 2; and
- Tier 2, the lower level, which is broadly equivalent to the 'Certificate III' level under the AQTF and applies to general insurance products except personal sickness and accident; BDPs and NCP facilities.

4.10 Advisers must complete training courses that are either listed on ASIC's Training Register or assessed by an authorised assessor as meeting the relevant skills and knowledge requirements. Licensees may develop their own courses in partnership with authorised assessors or have their own courses assessed by authorised assessors. Provision is also made for recognition in some instances of relevant industry experience as an alternative to the completion of formal training.

4.11 PS 146 provides a limited exemption from the training requirements for call centre or front-counter representatives who typically deal with initial customer queries where the only financial product advice they provide is:

- derived from a script approved by a person who meets the training standards; or
- made under the direct supervision of a person who meets the training standards.

Basic deposit products and non-cash payment facilities

Overview of objections

4.12 Submissions made and evidence given to the Committee, indicated quite significant opposition from ADIs to ASIC's prescription of Tier 2 training requirements for front-counter representatives advising customers on BDPs and related NCP facilities.[8]

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6 Submission 18.

7 PS 146.20.

8 Submission 2, pp. 1–2; submission 8, pp. 1–3; submission 9, pp. 1–4; submission 22, pp. 3–6; submission 25, pp. 3–4.

4.13 The main criticisms levelled at ASIC's training requirements were that they were excessive given what was described as the low-risk nature of BDPs and related NCP facilities. A number of witnesses argued that the requirements would impose a significant cost burden on ADIs with negligible, if any, benefits for consumers. The claim was made that, if anything, consumers would be disadvantaged by a withdrawal of banking services in remote and regional areas, not only because of costs, but also because of the impracticalities of training service providers in these areas. These issues are discussed below.

Objections in detail

Uncertainty of scope of 'financial product advice'—contribution to training costs

4.14 For some witnesses, a major source of concern regarding training costs was the uncertainty surrounding the scope of the definition of financial product advice.

4.15 It was commonly claimed in submissions and evidence given at the inquiry's hearings that front-counter representatives responding to customers' queries about BDPs and related NCP payment facilities generally provided factual information that was not financial product advice. However, the concern was expressed that it was difficult to determine with certainty where the line between factual information and financial product advice would be drawn. Most witnesses appearing before the Committee claimed that, because of this, they had no alternative but to train their front-counter representatives rather than risk being in breach of requirements.

4.16 In this regard, the Australian Finance Conference (AFC) said that:

> …there is a lot of confusion about what is advice, with many financial institutions being told that a financial services provider cannot issue a product without giving advice or coming so close to it they should play safe and assume the FSR Act advice provisions will apply.[9]

4.17 In a similar vein, the Australian Bankers' Association (ABA) stated that:

> …the Act actually creates a problem…in the way it defines 'advice'…Advice can constitute direct advice, albeit inferred from circumstances in the course of the discussion with the customer. If, in the course of discussions with a customer, it can be inferred that there is a recommendation being made by the bank officer that this customer should open this account rather than that account, then that bank officer has advised the customer…It will be virtually impossible to train staff to stay on the right side of the line, because they want to help customers.[10]

4.18 At the hearing, the Australian Association of Permanent Building Societies (AAPBS) commented that because providing factual information could constitute the

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9 *Committee Hansard,* 12 July 2002, pp. 216–17.

10 *Committee Hansard*, 11 July 2002, p. 99.

giving of financial product advice in some circumstances, there were concerns that a representative might inadvertently give financial product advice in an attempt to provide a customer-oriented service.[11] It highlighted the possibility that this might be more prevalent in country areas where there might be a more personal element involved in representative/customer interactions. Examples given by the AAPBS as possibly triggering a training requirement included:

- asking a customer opening a passbook account if a cheque facility was also required given that such facilities did not come with passbook accounts;
- asking a customer with a loan account if he or she would like an offset facility attached to the account to reduce interest payments; and
- suggesting that a customer might wish to use a direct debit facility rather than a cheque account to pay certain ongoing accounts because it was cheaper.[12]

4.19 At the hearing on 7 August 2002, ASIC's clarification was sought as to when information given to a customer might cross the line and become financial product advice. Ms Pauline Vamos, Director, FSR Licensing and Business Operations at ASIC, commented that:

> …you have to look at the whole situation; and, on the whole, the provision of factual information is not caught. But, with the relationship between the parties, [if] all the circumstances are such that the amount of reliance may move it towards, in that instance, general advice; again certain training and skills are required to provide that advice.[13]

4.20 Mr Malcolm Rodgers, Executive Director, Policy and Markets Regulation at ASIC, added:

> If [a front-counter representative] said, 'There are four accounts here; this one has these features, this one has those features and this one has those features,' [the representative] would probably be doing nothing more than describing something that exists as a matter of fact, and that is factual. But you do not need to go far in those circumstances to be saying, 'This one is the one for you.' That is where there is the question of whether you have crossed the line.[14]

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11 ASIC's guide to financial product advice says in paragraphs 1.2.4 and 1.2.5 that: 'Communications that consist only of factual information—ie objectively ascertainable information whose truth or accuracy cannot be reasonably questioned—will generally not involve the expression of opinion or recommendation and will not, therefore, constitute financial product advice. However, in some circumstances, a communication which consists only of factual information may amount to financial product advice, eg factual information which is presented in a manner which may reasonably be regarded as suggesting or implying a recommendation to buy, sell or hold a particular financial product or class of financial products.'

12 *Committee Hansard*, 11 July 2002, pp. 144–46.

13 *Committee Hansard,* 7 August 2002, p. 271.

14 *Committee Hansard*, 7 August 2002, pp. 271–72.

And later:

> [The definition of financial product advice] does have in it that notion of influence and it is conceivable that you can give a set of information, each element of which arguably is factual information but in the circumstances you are in fact giving advice.[15]

4.21 The Committee accepts that the distinction between financial product advice and factual information is not clear cut and appreciates the problems this might create in the practical situations referred to by the witnesses appearing for ADIs.

Course content is excessive in view of the products involved

4.22 Many submissions were critical of the skills and knowledge requirements of Tier 2 training which they claimed were excessive given the nature of BDPs and related NCP facilities. These products were characterised as simple, of negligible risk, well understood and not linked to markets.

4.23 More particularly with regard to the actual training requirements in Tier 2, the AAPBS stated that, for 'simple, well-understood, long established no-risk products':

- the generic knowledge requirement went beyond what was needed; [and]
- the skills requirement mirrored benchmarks for the financial planning industry and was irrelevant.[16]

4.24 At the hearing on 11 July 2002, the ABA, stated that:

> [PS 146] really fails to differentiate sufficiently the nature of a basic deposit product and the related non-cash payment facility as a class—which is your plastic ATM card—from a range of other products that are infinitely more sophisticated and have greater complications attaching to them. For example, for someone who wanted to assist a customer in deciding which account to open—be it a term deposit, a simple savings account or a transaction account—the training required to simply provide that service to the customer would involve economic training, understanding debt cycles and interest rate cycles, and would include product knowledge.[17]

4.25 The AFC submitted that the training requirements represented a significant upgrade for financial institutions without any added benefit for customers. It referred to its findings that only between two per cent to less than three per cent of front-counter transactions were financial services coming within the *Financial Services Reform Act 2001* (FSR Act). It questioned whether there was a consumer benefit to

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

16 Submission 2, p. 2 and letter to the Committee dated 17 July 2002.

17 *Committee Hansard,* 12 July 2002, p. 98.

justify the significant costs involved in training given what it claimed was the well-understood and low-risk nature of these products.[18]

4.26 A similar sentiment was expressed by the AAPBS which claimed that the training requirements were far in excess of what was required for 99 percent of its business.[19]

4.27 ASIC responded generally to ADIs' concerns about training requirements at the hearing on 7 August 2002. Ms Vamos indicated that the available training courses may not have been appropriate for the skill levels involved. However, she said that ASIC had been working with banks and deposit institutions to remedy this. She also reminded industry of the options for individual assessment or approved in-house training.[20]

Impact of training on the delivery of services in remote and regional areas

4.28 In relation to the impact of PS 146 on the availability of services in regional and rural areas, Bendigo Bank Limited said that:

> …implementation of certain aspects of PS 146, in its current form, will almost certainly reduce the level of service and assistance that Bendigo Bank customers experience, unnecessarily raise the cost of providing banking services—which will in turn result in increased costs to the consumer, and, most significantly, reduce competition in the finance sector by making it much more difficult to expand the Bendigo Bank branch and Community Banking network, in remote and regional areas (both in terms of finding trained staff and the expense associated with training those staff).[21]

4.29 Bendigo Bank also said that small branches would either have to instruct staff not given Tier 2 training to refrain from advising customers on appropriate product choices or train all customer service representatives to Tier 2 level. It claimed that the first option would greatly limit flexibility and customer education while the second option would result in reduced staffing levels and a reduction in banking services particularly in Community Bank and rural branches.[22]

4.30 Similar concerns were expressed in several other submissions which suggested that financial institutions would have considerable difficulties in retaining and attracting agents to conduct their deposit-taking business. The AFC said it was impractical to expect pharmacy or newsagency staff offering such services,

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18 Submission 25, p. 3.

19 *Committee Hansard,* 11 July 2002, p. 134.

20 *Committee Hansard,* 7 August 2002, p. 269.

21 Letter enclosing submission 8 dated 3 May 2002.

22 Submission 8, p. 3. See also submission 8A.

particularly in regional Australia, to undertake the required training.[23] The ABA stated that:

> The cost, inconvenience and business disruption associated with tertiary training for what might be an incidental activity for a small business operator is unlikely to be wanted by them with the possible resulting loss to the area of the banking service.[24]

4.31 The AAPBS commented that:

> If we have to train people, especially in the agencies and the newsagents, and have them assessed by an external RTO (Registered Training Organisation), it gets very costly and frankly [the AAPBS] cannot see how societies would continue having these agencies.[25]

4.32 And the Bendigo Bank said that:

> The effect of the cost and requirements of training staff has already become apparent with 90 Bendigo Bank agents having to examine their viability as Bank agents because of the cost and time required for PS 146 training for agency staff.[26]

4.33 At the hearing on 7 August 2002, Mr Rodgers from ASIC said that PS 146 had tried to cater for remote areas where training might not be feasible by allowing for the use of a script (in lieu of training) by a properly supervised front-counter representative. He commented, however, that this option would not meet everyone's needs and that there might be an 'irresistible temptation to go beyond a script' in rural agencies.[27]

4.34 At one of the Committee's earlier hearings, Mr Ian Johnston, Executive Director, Financial Services Regulation at ASIC, advised that he thought the script would be more relevant for call centres, and the supervision model more suitable for front-counter representatives.[28] Ms Vamos also from ASIC, indicated that the exemption would only be useful where front-desk representatives conducted a very limited dialogue with customers and that, otherwise, banking and other types of deposit-taking institutions would generally be training to Tier 2 standard.[29]

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23 Submission 25, p. 4.

24 Submission 22, p. 5.

25 *Committee Hansard*, 11 July 2002, pp. 143–44.

26 Supplementary submission 8A.

27 *Committee Hansard,* 7 August 2002, p. 272.

28 *Committee Hansard*, 23 May 2002, p. 83.

29 *Committee Hansard*, 23 May 2002, p. 84.

4.35 When questioned by the Committee about the applicability of the script exemption, the ABA said that, because a script lacked the flexibility needed to deal with the variables involved in customer inquiries, it was not a workable alternative.[30]

4.36 The Credit Union Services Corporation (Australia) Limited (CUSCAL) stated that the script and supervision exemptions had no application in small branches or agencies in rural areas.[31]

4.37 Although there was some debate at the hearings about using front-counter representatives as a sales force for more complex financial products, the Committee accepted that the issues involved concerned disclosure rather than training. In this regard, CUSCAL stated:

> We are not concerned about the impact of PS 146 on 'cross-selling' or 'up-selling' or advice about financial products other than basic deposit products and non-cash payment facilities.[32]

Costs

4.38 The high costs involved in meeting the requirements of PS 146 were viewed in the submissions as being disproportionate to any potential gains in customer protection.

4.39 Mr David Thorpe for the AFC, said at the Committee's hearing on 12 July 2002, that he had received estimates from members ranging from $300 to $1,000 per person.[33] The Bendigo Bank estimated initial training costs of approximately $945,179.00 with a minimum additional amount of $630,000 for the following year.[34] At the Committee's hearing on 23 May 2002, CUSCAL said that about 6,000 credit union staff would have to be trained or assessed to be competent against the benchmarks set in PS 146 at a minimum cost of approximately $3 million.[35] For the AAPBS, estimated costs ranged from $440 to $900 per employee whether it involved an ASIC-approved course or internal training developed with an authorised assessor such as a Registered Training Organisation (RTO) approved by ASIC.[36]

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30 *Committee Hansard,* 11 July 2002, p. 100.

31 Supplementary submission 9, p. 2.

32 Supplementary submission 9A.

33 *Committee Hansard*, p. 217.

34 Submission 8A.

35 *Committee Hansard,* p. 30.

36 Letter to the Committee dated 17 July 2002.

4.40 The AFC commented at the hearing on 12 July 2002, that requirements for RTOs to maintain records and issue certificates for all trainees would further blow out training costs.[37]

Proposed alternatives to PS 146 requirements

4.41 CUSCAL criticised as excessive not only the training standards for BDPs, but also those for deposit products other than BDPs. It stated in its submission that PS 146:

- [was] not clear and straightforward;
- [did] not recognise the unique status of 'basic deposit products' and related payment products in the Act; and
- [categorised] deposit products that [were] not basic deposit products in Tier 1 instead of Tier 2.[38]

4.42 CUSCAL argued that the training requirements imposed by PS 146 for advice on BDPs and related NCP facilities as well as for deposit products other than BDPs, were disproportionate to the nature of the advice involved. It claimed that ASIC's adaptation of PS 146 to fit in with the new regime failed to take into account the unique treatment accorded in the FSR legislation to ADI deposit products which recognised their status as capital guaranteed and well understood by consumers.

4.43 A number of witnesses took the view that a separate 'Tier 3' training category was needed for BDPs and related NCP facilities. The proposed content of the training in Tier 3 varied from 'product knowledge'[39] to what was already contained in in-house training manuals.[40]

4.44 CUSCAL suggested that a Tier 3 training category could either be met by RTOs or licensees' own in-house programs. For deposit products other than BDPs, it also suggested that Tier 2 rather than Tier 1 training should apply.

4.45 At the Committee's hearing on 11 July 2002, the ABA argued that a new product knowledge training category for BDPs would be an appropriate alternative to Tier 2 training given the special features of BDPs.[41] The AAPBS considered that training manuals which its members currently had in place for their deposit-taking transactional business would be a satisfactory training tool.[42] The AFC proposed a Tier 3 training category using existing training manuals and suggested that section

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37 *Committee Hansard*, p. 216.

38 Submission 9, p. 2.

39 Ian Gilbert, *Committee Hansard*, 11 July 2002, ABA, p. 101.

40 James Larkey, *Committee Hansard*, 11 July 2002, AAPBS, p. 134.

41 *Committee Hansard*, p. 101.

42 *Committee Hansard*, 11 July 2002, p. 134.

912A of the *Corporations Act 2001* placed an obligation on licensees in any event to ensure all representatives were adequately trained.[43]

4.46 In response to proposals for a new training category, ASIC commented that:

> Again, it is more about making sure the training is appropriate. Whether there are three tiers, two tiers or five tiers, it is about making sure that there are courses out there that fit the services being provided. Certainly, a lot of entities that only provide services in relation to tier 2 products have raised the issue of the skills required to provide those products. Even for tier 2 training, many of the courses train people at the skill level of providing a financial planning type service—'know your client' and that sort of thing. It is a matter of pulling that back. Again, that is covered in PS146; it just has not translated in many of the courses being provided.[44]

and also that:

> The overall message we would give there is that we will maintain the integrity of the two-tier system. But we understand that there may be some difficulties in various areas, and we will work to try to be flexible and tailor things as much as we can.[45]

The background to ASIC's formulation of training requirements

4.47 ASIC formulated PS 146 following a period of public consultation commencing with the release of a policy proposal paper on 26 April 2001.[46] The final policy was published on 28 November 2001.

4.48 Although PS 146 was formulated in consultation with interested stakeholders, CUSCAL, the ABA and AAPBS claimed that the training requirements failed to reflect the special characteristics of BDPs and related NCP facilities.

4.49 In particular, CUSCAL commented that:

> The interim policy statement—IPS 146—was drafted well before the final provisions of the FSR regime were settled. One of the most contentious issues in developing the FSR policy development process was the status and treatment of deposits with ADIs. The status of ADI deposit products as capital guaranteed and well understood by consumers was given distinct recognition in the FSR legislation but this was not reflected in the ASIC Policy Proposal Paper 3 Adapting IPS 146 to the FSR Regime. Indeed, there was virtually no acknowledgment in PPP 3 of this significant policy development process and its outcome.[47]

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43 *Committee Hansard*, 12 July 2002, p. 218.

44 Pauline Vamos, *Committee Hansard,* 7 August 2002, p. 280.

45 Ian Johnston, *Committee Hansard,* 7 August 2002, p. 280.

46 *Policy Proposal Paper No.3–Licensing: Adapting IPS 146 to the Financial Services Reform*.

47 Submission 9, p. 3.

4.50 Likewise the ABA stated that:

> [PS] 146 was actually there before FSR came along. It was there for securities advisers and dealers. It simply was recast as an interim policy statement in the lead-up to the passage of the Act. It has been altered since then, but, fundamentally, its structure is very much the same.[48]

4.51 And, in a similar vein, the AAPBS said at the hearing that:

> [PS 146] originated from interim policy statement 146, which preceded quite a lot of the FSR. I suspect it was not written for the banking culture or our branch culture and that is why it has things in it that are unnecessary. Frankly, we do not have any evidence that it was sensibly modified to meet the requirements of deposit taking institutions.[49]

The Committee's earlier findings regarding regulation of BDPs

4.52 During the Committee's inquiry into the exposure draft of the Financial Services Reform Bill conducted in 2000, submissions were received from banks, building societies and credit unions concerning the inclusion of basic deposit products in the definition of 'financial product'. In its *Report on the Draft Financial Services Reform Bill* dated August 2000, the Committee concluded that:

> …the inclusion of basic banking products within the ambit of the draft Bill imposes requirements on approved deposit taking institutions which would have a devastating effect on the level of services offered by agencies of these institutions in regional areas…Moreover, the Committee also recognises that the disclosure and training requirements associated with more complex financial products—which are by nature investment products—are inappropriate for basic banking products where there have been few concerns expressed about inadequate consumer protection. Furthermore, the Committee recognises that such requirements on basic banking products are not aligned with the express intent of the Wallis Inquiry on this matter.[50]

4.53 The Committee proposed an amendment to the definition of 'financial product' to exclude basic deposit products provided by ADIs.[51] This proposal was not adopted but amendments provided that deposit products offered by ADIs for a term of two years or less and having no management or break fees would not generally be subject to the Financial Services Guide or Statement of Advice requirements. This concession took into account that BDPs are capital guaranteed and well understood by consumers.

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48 *Committee Hansard*, 11 July 2002, p. 100.

49 *Committee Hansard*, 11 July 2002, p. 134.

50 Page 28.

51 Pages 28–29.

4.54 Following the Committee's second inquiry into the Financial Services Reform Bill 2001, the Committee again recommended that BDPs be exempted from the definition of 'financial product'. As with its findings in the earlier inquiry, the Committee was concerned that the increased compliance costs associated with BDPs would not lead to greater consumer protection and, in fact, would increase costs to consumers while threatening the availability of these products in remote areas.[52]

4.55 The Committee's recommendations were not adopted.

The Committee's views

4.56 It appears to the Committee that the uncertainty surrounding the ambit of the definition of 'financial product advice', and the compliance issues arising from this, may prompt more widespread training of front-counter representatives advising on BDPs and related NCP facilities than was initially anticipated.

4.57 In this regard, the Committee accepts the comments made by ADIs and their member associations that the 'script' and 'supervision' alternatives to training provided by PS 146 are not workable in practice, particularly in agencies and branches in regional and remote areas, and that formal training will consequently be required.

4.58 The Committee notes that BDPs and related NCP facilities are well understood by retail consumers and are offered by prudentially regulated entities. It accepts the evidence given by the AFC that only a very small proportion of the transactions handled by front-counter representatives come within the purview of the FSR Act, and again concludes that there is insufficient consumer benefit to justify the costs.

4.59 The Committee recognises that PS 146 allows for the assessment of in-house courses by ASIC-approved RTOs. However, it notes the AAPBS's comments that its costs would be much the same regardless of whether the courses were conducted externally or approved by an RTO for in-house training.

4.60 The Committee understands that ASIC is required to formulate policy to reflect the objectives of the legislation involved. It further understands that the training requirements with which licensees must comply, have a strong consumer-protection focus.

4.61 Notwithstanding this, the Committee believes that the training requirements in PS 146 for representatives advising on BDPs and related NCP facilities go beyond what is necessary given the nature of the products involved, the high costs associated with training and the questionable benefits to consumers.

4.62 The Committee notes ASIC's evidence that it is presently examining the available courses to ensure they are more appropriate to the nature of the financial products involved.

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52 *Report on the Financial Services Reform Bill 2001,* August 2001, p. 89.

4.63 However, the Committee considers that in setting the training requirements for persons advising on BDPs and related NCP facilities, PS 146 is not consistent with the objective of the FSR Act to promote consumers' interests while facilitating efficiency and flexibility in the provision of these products and services.

4.64 In addition, the Committee notes the evidence presented to this inquiry and, indeed, its two previous inquiries regarding FSR legislation that regulation of BDPs and related NCP facilities will seriously threaten agency and branch banking services in remote and regional areas.

4.65 Furthermore, the Committee agrees that formal training requirements imposed on agencies and small branches would be disproportionately costly as well as difficult to implement. The Committee is particularly concerned that the closure of services in these areas could have far-reaching adverse impacts on local communities.

4.66 The Committee believes it was not the Government's intention that the FSR legislation would have a deleterious effect on remote and regional areas.

4.67 In this regard, the Committee refers to the comments of the then Minister for Financial Services and Regulation, the Hon Joe Hockey MP, when introducing the FSR Bill into Parliament, that:

> The [FSR] framework will also be capable of flexible implementation so that it can apply differently to different products where this difference can be justified within the overall objectives of the regulatory framework.
>
> Basic deposit products will be subject to less intensive regulation than more complex investment products.
>
> This will ensure that the bill will not jeopardise the cost-effective provision of basic banking services, especially in rural and regional areas.[53]

4.68 The Committee believes that the fundamental problem underlying the difficulties associated with PS 146, is the inclusion of BDPs and related NCP facilities within the scope of FSR regulation.

4.69 The Committee further believes that the provision of BDPs and related NCP facilities does not need to be regulated by the Act and concludes that the Government should exempt these products from the definition of 'financial product' and hence, makes the following recommendation:

Recommendation

The Committee, for the third time, recommends that the Government, either by amending the Corporations Act or regulations, should remove basic deposit products and related non-cash payment facilities from the definition of 'financial product'.

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53 Second Reading Speech, 5 April 2001, *House Hansard*, p. 26522.

4.70 Should the Government inexplicably continue to ignore the evidence and arguments put forward by the Committee and fail to act with commonsense by implementing this recommendation, then the absolute minimum acceptable response is to implement the following recommendation, which the Committee nevertheless regards as a very inadequate substitute for the above recommendation.

Recommendation

The Committee recommends that ASIC urgently review the training requirements in PS 146 so they take into account the special features of basic deposit products and related non-cash payment facilities.

Recommendation

In addition, the Committee recommends that ASIC consider amending PS 146, as far as possible—and without compromising consumer protection—to:

- **provide a framework for more cost-effective reviews of ADIs' current in-house training requirements;**
- **ensure training costs—whether in-house or external—are more proportionate to envisaged consumer protection gains; and**
- **cater for the training challenges presented by agencies and small branches, particularly in regional and remote areas.**

Objections to other training requirements

4.71 The IAG commented on the requirement that staff advising on personal accident and sickness insurance products meet the Tier 1 educational level.

4.72 It argued that Tier 1 training would not render any significant industry protection for consumers and said these particular insurance products would be more appropriately grouped with other general insurance products so that training to Tier 2 rather than to Tier 1 level was required. It claimed that, under current industry practice and experience, staff advising on personal accident and sickness insurance products were required to have the relevant theoretical knowledge and that this accorded with the Certificate III or Tier 2 standards.

4.73 The IAG also asked whether the Tier 1 training level would apply to staff advising 5 per cent of the time on personal accident and sickness insurance products but the rest of the time on Tier 2 products.[54]

4.74 The NIA expressed concerns that PS 146 failed to recognise accountants' professional qualifications in relation to the provision of general advice in certain areas. The view was that accountants already held the qualifications necessary to conduct their professional activities so, if licensing were required, they should not have to complete additional courses prescribed by PS 146.

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54 Submission 28, p.3.

4.75 This is discussed further in Chapter 5 which deals with the conditional licensing exemption for accountants in regulation 7.1.29.

The Committee's views

4.76 The Committee notes the evidence given by IAG that the Tier 1 standard applied to staff advising on personal accident and sickness insurance is too high. However, the Committee is not convinced that the level of training for personal accident and sickness insurance advisers is inappropriate. The Committee therefore considers that no further action is necessary.

Recognition of experience

4.77 PS 146 provides an alternative to the completion of approved training courses. This is the recognition of relevant experience. Where an adviser has at least 5 years' relevant experience in the immediate 8 years, individual assessment by an authorised assessor is an option.[55]

4.78 Freehills commented that its clients were concerned about the arbitrary application of the 5 years in 8 rule. It suggested that advisers with significant and worthwhile experience of less than 5 years should not be treated in the same way as a person having no industry experience.[56]

4.79 The Australian Associated Motor Insurers Limited (AAMI) submitted that the 5 years in 8 rule was arbitrary and that recognition of all time spent as an adviser in relevant areas should be recognised. It endorsed the approach taken by the Australian National Training Authority which it said did not apply the rule as a mandatory qualifier for assessment of earlier-acquired competencies.[57]

The Committee's views

4.80 On the basis of evidence presented by ADIs (for BDPs and related NCP facilities), CPA Australia and Mr Peter Davis (for training of financial planners),[58] the Committee accepts that formal training requirements prescribed by PS 146 can entail substantial costs.

4.81 The Committee notes that the Australian Quality Training Framework (AQTF) does not impose thresholds such as the 5 years in eight rule as mandatory qualifiers for the assessment of prior experience.

4.82 However, the Committee considers that the financial services to which training requirements relate, are often complex and not well understood by retail consumers. The Committee is consequently not persuaded that the costs involved

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55 PS 146.52–146.53.

56 Submission 7, p. 6.

57 Submission 18, p. 3.

58 Details of the evidence given by CPA Australia and Mr Peter Davis are in Chapter 5.

outweigh the potential reduction in the quality of advice given to consumers and recommends that the 5 years in 8 rule remain in place.

CHAPTER 5

Accountants

Licensing and related matters

Introduction

5.1 The Committee received several submissions and heard evidence from professional accounting bodies and a taxation and accounting practice which indicated widespread confusion and dissatisfaction across the industry about the licensing exemptions.

5.2 Although some relief is provided to registered tax agents by paragraph 766B(5)(c) of the FSR Act, this was regarded by some witnesses as not going far enough.

5.3 The most significant dissatisfaction was with regulation 7.1.29 which was described as confusing, unworkable and in urgent need of clarification. The regulation may have been intended to provide a licensing carve-out for the activities specified in subregulation (1). However, this is not clear.

5.4 A number of submitters maintained that accountants needed to know whether or not their activities would fall within an exemption but regulation 7.1.29 did not provide the guidance needed. They were concerned about what they contended were high licensing costs and the ramifications for accountants who sought authorised representative status. In addition, ASIC's Policy Statement 146: *Licensing: Training of financial product advisers* (PS 146) attracted some criticism on the grounds that its training requirements for accountants were inappropriate and costly.

5.5 These issues are discussed in this Chapter.

Exemption from licensing

5.6 Submissions from the Institute of Chartered Accountants of New Zealand (ICANZ), Peter Davis Taxation & Accounting Services (Peter Davis Accounting), The Institute of Chartered Accountants in Australia (ICAA) and CPA Australia (CPAA)(joint submission), the National Institute of Accountants (NIA), the Taxation Institute of Australia (TIA) and the National Tax & Accountants' Association (NTAA) all argued for a licensing exemption for what were generally termed as 'traditional accounting activities'.[1]

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1 See submissions 3, 11, 12, 16, 27 and 34 respectively.

5.7 Although most of the debate focussed on the industry's dissatisfaction with regulation 7.1.29 (which will be discussed later in this chapter), it was implicit in their evidence that a licensing exemption was unanimously supported.

5.8 In particular, there was agreement that licensing of accountants would be appropriate where they provided financial product advice as a core part of their activities or where commission or other remuneration from a third party was paid in relation to the advice. However, where traditional accounting activities were concerned, the general consensus was that there should be an exemption.

5.9 The ICAA and CPAA argued that a licensing exemption for traditional accounting activities was consistent with the Financial System Inquiry's (Wallis Inquiry's) Final Report that found:

> Financial advice is often provided by professional advisers such as lawyers and accountants. This advice is typically provided in the context of broader advisory services offered to clients extending beyond the finance sector, often where an adviser has a wide appreciation of the business and financial circumstances of a client. In such cases, the best course is to rely upon the professional standing, ethics and self-regulatory arrangements applying to those professions.
>
> However, a clear distinction needs to be drawn if an adviser acts on an unrebated commission or similar remuneration basis which substantially alters the character of the relationship with a client and places such advisory activities on a footing similar to that of other financial advisers. In such cases, financial market licensing should be required.[2]

5.10 The NIA commented that the 'Incidental Advice Exemption' in the previous legislation had worked well because it recognised the wide array of advice incidental to general advice that accountants dispensed to their clients.[3]

5.11 It appeared from the submissions and evidence that the relief afforded to registered tax agents by the legislation had a limited application in practice for those accountants who also held a tax agent's licence. According to the NIA, most work performed by accountants was outside the tax agents' exemption and was more in the nature of 'independent business advice'.[4] There was also the difficulty in determining where the line would be drawn between the exempted tax agent's activities and other work engaged in by accountants.

5.12 The NIA argued that, if accountants were required to obtain licences for their traditional accounting activities, the costs associated with licensing would threaten the delivery of services by smaller suburban accounting practices which currently provided a cost-effective, 'one-stop shop' to consumers. In this regard, the TIA and

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2 *Financial System Inquiry Final Report*, March 1997, pp. 275–76.

3 Submission 16, p. 2.

4 Submission 16, p. 5.

Peter Davis Accounting adverted to the potentially serious ramifications for self-managed superannuation funds, the majority of which were managed and administered by smaller suburban practices.

5.13 The argument was also advanced that additional regulation, other than imposing quite substantial licensing and compliance costs on the profession, would not result in increased consumer protection or any other benefits.

5.14 At the hearing on 11 July 2002, Mr Reece Agland, General Counsel, NIA, listed various consumer safeguards already in place such as requirements that accountants are insured, belong to professional bodies, satisfy continuing professional educational requirements, observe codes of conduct and practice quality assurance.[5]

5.15 While a licensing exemption for accountants was the overriding concern in submissions and evidence given, the main focus of debate was on how the exemption could be achieved. In this regard, the efficacy of regulation 7.1.29 was seriously questioned.

The exemption in regulation 7.1.29

Analysis of the regulation

5.16 The contentious features of regulation 7.1.29 are in subregulations (1) and (2).

5.17 Subregulation 7.1.29(1) lists 'circumstances' in which recognised accountants will be taken not to be providing a financial service within the meaning of paragraph 766(1)(a) of the FSR Act. The circumstances are as follows:

- advising in relation to the preparation or auditing of financial statements;
- advising or acting in the capacity of a controller, administrator, receiver, manager, liquidator or trustee in bankruptcy in relation to the administration (including the disposal) of an entity or estate;
- advising on the financing of the acquisition of assets that are not financial products (for example, advising on the advantages and disadvantages of financing alternatives such as leasing and hire purchase);
- advising on the processes for the establishment, structuring and operation of a superannuation fund within the meaning of the *Superannuation Industry (Supervision) Act 1993* (SIS Act);
- advising on debt management, including factoring, defeasance and the sale of debts;
- advising on taxation issues, including in relation to the taxation implications of financial products;

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5 *Committee Hansard*, 11 July 2002, p. 167.

- advising on the management of risk associated with conducting a business, including risk management through the use of financial products (for example, hedging);
- advising on business planning, including advice in relation to the establishment, structuring and administration of a business;
- conducting a due diligence on a business; and
- valuing the assets of, or shares in, a business, or part of that business.

5.18 However, in subregulation 7.1.29(2) there is a proviso. If the activities in subregulation (1) involve the accountant in making a recommendation, providing a statement of opinion or giving a report of either of those things that is intended to (or could reasonably be regarded as being intended to) influence a person in making a decision in relation to a particular financial product or a class of financial products, the exemption no longer holds.

5.19 In other words, if the accountant gives what amounts to 'financial product advice' in the course of carrying out any of the activities in subregulation (1), there is no exemption.

The objections to regulation 7.1.29

5.20 A number of witnesses called for the regulation to be amended urgently to give the accounting industry some certainty about where it stood in relation to the new licensing regime. Criticisms were made that the regulation defied interpretation and did not work. It did not work, according to evidence given, because an accountant providing the services in subregulation (1) would, as a matter of course, make recommendations and give opinions about financial products. Mr Gavan Ord, Technical Policy Manager, NIA, summarised the problem thus:

> It is nigh on impossible [for accountants] to provide the sort of advice set out in subregulation (1) without having an influence on a client making a decision in relation to a particular product or class of products. Even where the adviser has not recommended or even suggested to invest in a particular product, their advice will influence the client in making a decision.[6]

5.21 In a similar vein, the ICAA and CPAA stated that:

> The main problem with the existing regulation is that the exclusion of financial product advice from the exemption renders the regulation itself virtually meaningless. Since 'financial product advice' is so broadly defined, accountants will *in the ordinary course of their duties as accountants* be providing it even though to regulate such activities does not seem consistent with the intention of the legislation.[7]

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6 *Committee Hansard,* 11 July 2002, p. 162.

7 Submission 12, p. 4.

5.22 Mr Gil Levy, Senior Vice-President and Treasurer of the TIA, argued that many of the everyday activities of accountants would not qualify for the licensing exemption in regulation 7.1.29 because they necessarily involved the accountant's assessment of and recommendations on various alternatives open to clients. He stated that it seemed anomalous that, without a licence, an accountant experienced in giving advice on a range of business matters would have to refer a client to a financial planner for a recommendation or opinion.[8]

5.23 On the subject of how the carve-out could be achieved, the ICAA and CPAA provided a suggested re-draft in their submission. This retained the activities listed in subregulation (1) but re-fashioned the proviso in subregulation (2). The effect of the re-draft was that the exemption would only apply to the listed activities if they were provided in the ordinary course of the accountant's activities and could reasonably be regarded as a necessary part of those activities. The exemption did not apply where the provision of financial product advice was a significant part of an accountant's usual activities or otherwise where remuneration including commission or other benefits were paid to the accountant by third parties.[9]

5.24 The NIA expressed support at the hearing for the nature and extent of the carve-out proposed by the ICAA and CPAA.[10] The TIA agreed that amendment was necessary and suggested that some of the anomalies with the regulation might be overcome by allowing accountants to provide a recommendation or opinion on business structure.[11]

5.25 At the hearing on 7 August 2002, officers from the Department of the Treasury advised:

> …we are in active discussions with the accounting professional bodies in relation to the regulation that was drafted in consultation with those bodies. We are in discussions with them about something that might be more workable in terms of defining the activities of an accountant which might not be totally included in the regulation.[12]

5.26 When questioned about the Department's progress in drafting an amended regulation, the Department responded that:

> At the moment the ball is largely in the accounting bodies' court. We are basically waiting for guidance from them about the sorts of specification and description of the types of activities they feel should be excluded.[13]

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8 *Committee Hansard*, 11 July 2002, pp. 169–70.

9 Submission 12, pp. 7–8.

10 *Committee Hansard*, 11 July 2002, p. 162.

11 *Committee Hansard*, 11 July 2002, pp. 172–73.

12 *Committee Hansard,* 7 August 2002, p. 261.

13 *Committee Hansard,* 7 August 2002, pp. 260–61.

5.27 Concerns were raised in the submissions and at the hearings about what was perceived as a lack of guidance from ASIC on how it would enforce regulation 7.1.29.

5.28 In this regard, officers from ASIC said that, given the industry's ongoing negotiations with the Department of the Treasury, ASIC considered the matter to be one of law reform and consequently did not intend to issue further guidance on the regulation.[14]

Licensing costs and accountants' independence

5.29 At the hearings, concerns were also raised about the independence of accountants who sought to become authorised representatives of licensees. In this regard, Mr Ord for the NIA said that:

> Many accountants, many of our members, express to us—contrary to what people say—that they do not want to become financial planners; they do not want to become authorised representatives. Why? Because they are then stuck with selling certain products and they believe that it is impairing their independence to give advice. As was said by the Financial Planners Association, if you become an agent of a licence holder, you have to meet certain criteria. You have to sell a certain number of products each year to maintain your agent status.[15]

5.30 This view was supported by confidential evidence received from an accountant and tax agent. More particularly, the claim was made that licensees were requiring their authorised representatives to meet marketing targets as a condition of keeping their authorised representative status. [16]

5.31 Ms Kathy Bowler, Manager, Financial Planning, CPAA, suggested that there was a relationship between the cost of licensing and the independence of authorised representatives. She said that:

> The fact is that no-one…will give our members a licence, because they are not selling product and making money for [the licensees]. Most licence holders run at a loss; they are a loss leader and make their money through the product.[17]

5.32 At the hearings, concerns were expressed about the cost of licensing and the ramifications for accountants' professional independence. The question was raised whether authorised representative status really offered accountants a viable alternative to licensing.

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

15 *Committee Hansard*, 11 July 2002, p. 167.

16 Confidential submission 40.

17 *Committee Hansard,* 11 July 2002, p. 167.

5.33 Ms Bowler commented that CPAA had been looking at the possibility of becoming a licensee to provide an avenue for its members to become authorised representatives. Ms Bowler said the proposal was only intended to cover those members who wanted to practice as financial planners but who were not prepared to earn remuneration from the promotion or endorsement of specific financial products. She claimed that these members were having problems in finding licensees to take them on as authorised representatives.[18]

5.34 Ms Bowler said her estimates of licensing costs where no product advice was given, worked out to somewhere in the realms of between $12,000 to $15,000 per annum per adviser on a cost recovery basis. She estimated that for authorised representatives making recommendations about specific products, the costs would work out to about twice that much. These factored in the costs of training, compliance, software and research.

5.35 When asked by the Committee whether she agreed with the statement by Ms Vamos in her letter to the NIA dated 5 July 2002[19] that licensing costs for most accountants would be minimal, Ms Bowler replied that:

> 'Minimal' certainly does not describe the cost we have come up with.[20]

5.36 The Committee was keen to gauge an industry cost from these figures and, using a notional figure of 150,000 accountants who had to be licensed, estimated the cost would be between $1.8 billion (assuming a restricted licence cost of $12,000 per adviser) and $3.6 billion (assuming $24,000 per adviser on an unrestricted basis).[21]

Training requirements

5.37 Some submitters were critical about ASIC's training requirements in PS 146 as they apply to accountants providing financial product advice. (PS 146 was discussed more fully in a previous chapter of this report.)

5.38 The NIA argued that the training was inappropriate for accountants and failed to give due recognition to the professional qualifications and continuing training obligations of accountants.[22]

5.39 Mr Peter Davis, an accountant and tax agent appearing in a private capacity at the hearing, said he had not been able to determine which of his activities would fall within the licensing exemption and which would not. He was concerned that although he held professional tertiary qualifications, was a registered tax agent, and complied with his continuing professional education obligations, PS 146 appeared to require

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18 *Committee Hansard,* 11 July 2002, pp. 175–76.

19 See Appendix 3.

20 *Committee Hansard,* 11 July 2002, pp. 175–79.

21 *Committee Hansard*, 11 July 2002, pp. 175–77.

22 Submission 16, p. 12.

him to undertake a financial planning course to qualify for a licence. He said he had been quoted between $5,000 and $7,000 for such a course. He indicated, however, that he was not sure how his qualifications or experience would be treated under PS 146 on an individual assessment basis.[23]

5.40 ASIC was not questioned specifically about the impact of PS 146 on accountants seeking a financial services licence. However, the Committee does appreciate that PS 146 allows applicants to undergo individual assessments as an alternative to formal training if they have had 5 years' relevant experience over the immediate past 8 years.[24] ASIC has referred to this option at the Committee's hearings.

The Committee's views

5.41 The Committee accepts the evidence from the accounting industry that regulation 7.1.29, as presently drafted, is causing widespread uncertainty and confusion among accountants. It also accepts that increased regulation of accountants will add to costs which will be passed on to consumers with little, if any, added consumer protection. Of considerable concern to the Committee, is the threat posed by these additional costs to small accounting practices and the delivery of cost-effective services to the self-managed superannuation fund industry.

5.42 The Committee considers that these outcomes are inconsistent with an objective of the FSR Act to facilitate efficiency, flexibility and innovation in the provision of financial products and services.

5.43 The Committee further considers that licensing requirements for accountants should be clarified urgently. In this regard, the Committee makes the following recommendation:

Recommendation

The Committee recommends that the Government amend the Corporations Act or regulation 7.1.29 to provide a licensing exemption for accountants in similar terms to the exemption provided to lawyers in paragraphs 766B(5)(a) and (b) of the Act. The exemption should also make it clear that it will not apply where the exempted activity attracts payment of commission or other benefit from a third party not connected with the client.

5.44 The Committee notes that this recommendation is consistent with the recommendation of the Wallis Inquiry to the effect that accountants should not have to be licensed if they provide investment advice only incidentally to their other business

23 *Committee Hansard*, 11 July 2002, pp. 198–207.

24 Paragraph PS 146.42.

and rebate any commissions to clients.[25] It is also consistent with the Committee's recommendation in its report on the Financial Services Reform Bill 2001.

5.45 In relation to the training requirements prescribed in PS 146 for accountants wishing to engage in financial planning as opposed to traditional accounting activities,[26] the Committee is satisfied that ASIC has made provision for recognition of an applicant's existing qualifications and experience through its individual assessment option. However, the Committee does not favour the application of the 5 years in 8 threshold for individual assessment for accountants seeking a licence to provide traditional accounting services. Should the Government provide a licensing exemption for these services according to the Committee's recommendations, the suitability or otherwise of the PS 146 training requirements will not be a live issue.

5.46 The continuing problems arising to date from the Government's preferred approach, which has remained at odds with this Committee's previous recommendations, raises the question of what is informing the Government's policy on this matter, which in the Committee's view has consistently been flawed.

5.47 While not directly within this inquiry's terms of reference, the Committee notes the evidence given by some submitters about threats to the independence of accountants seeking authorised representative status. The Committee considers it would be premature to draw any definite conclusions at this early stage. However, it is disturbed by suggestions that accountants without the resources to obtain a financial services licence might find themselves under pressure to market financial products should they seek authorised representative status.

5.48 This outcome is inconsistent with the objectives of the FSR Act to promote flexibility in the industry. In the circumstances, the Committee draws ASIC's attention to these claims and encourages it to monitor developments closely. The Committee would be prepared to consider any additional information about this issue as industry adjusts to the new regime.

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25 *Financial System Inquiry Final Report*, March 1997, pp. 275–76.

26 'Traditional accounting activities' are those which the Committee recommends should be exempted from the FSR Act licensing requirements.

CHAPTER 6

Disclosure

Introduction

6.1 During the inquiry, a number of issues were raised in connection with superannuation and insurance. The most contentious related to the ongoing management charge (OMC) which superannuation funds were required to disclose in their Product Disclosure Statements (PDSs).

6.2 In the insurance area, two issues emerged—the disclosure exemption at PDS level for commission paid on risk products in certain circumstances and the limitation of the disclosure requirement regarding unauthorised foreign insurers to the retail market only.

6.3 This chapter will explore the inquiry's findings.

Superannuation—ongoing management charge

Background

6.4 In the Senate on 16 September 2002, the regulations prescribing disclosure of the OMC were disallowed on a motion given by Senator Stephen Conroy.

6.5 Under the new provisions, most superannuation funds will have to provide fund members with a PDS. The regulations prescribe the content of the PDS for superannuation funds. Among other things, they set out in detail how the ongoing management charge (OMC) was to be reported in these documents.[1] The regulations provided a definition of OMC.[2]

6.6 Calculation of the OMC attracted substantial criticism from consumer and industry groups although one industry group expressed satisfaction with requirements. Most witnesses maintained that the OMC would not assist comparability between funds and was misleading.

Review of submissions and evidence heard

6.7 Among the critics of the OMC was the Australian Consumers' Association (ACA). The ACA queried whether the inclusion of the OMC in the PDS for superannuation products achieved the objectives stated in the Explanatory Memorandum, namely, that the PDS was 'to provide consumers with sufficient information to make informed decisions in relation to the acquisition of financial

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1 Regulation 7.9.11 and Schedule 10B of the Corporations Regulations.

2 Subregulation 7.9.01(1) and Schedule 10 of the Corporations Regulations.

products including the ability to compare a range of products'. In particular, concerns were expressed that:

> …the OMC does not capture entry and exit charges, which can have a severe impact on the potential returns to the consumer, and may thereby underestimate the costs of the product.
>
> Schedule 10 of FSRA stipulates the requirements for the PDS and OMC. These include that the OMC be displayed as an investment OMC, non-investment OMC and total OMC over a period of 5 years and that these be further broken down into dollar amounts against an account balance of $10,000. In practice, this can translate to a bewilderingly complex array of calculations, not easily comparable with other products.[3]

6.8 In a similar vein, Freehills commented that:

> The question is, though, whether [the OMC] will actually produce any meaningful information for the member of the fund, because potentially the management charge has two components—it has an investment component and an administration component—and then, if there are investment strategies within a fund, the charge has to be given for each strategy. So with some funds that offer, let us say, 20 investment choices, the multiplicity of figures that will be produced could be absolutely dazzling and quite mind boggling.[4]

6.9 In its submission, the Association of Superannuation Funds of Australia Limited (ASFA) endorsed the principle of standardised disclosure, but argued that there were critical deficiencies in the calculation of the OMC. ASFA argued that the OMC would not facilitate comparability of funds but merely produce 'an impenetrable maze of numbers'. In this regard, ASFA said that, for a fund with five investment options, upwards of 75 separate OMCs (as ratios) and 25 flat dollar amount conversions would have to be disclosed.

6.10 ASFA cited the following specific concerns about the calculation of and PDS requirements for the OMC:

- the formula for the OMC does not include entry and exit fees that might dramatically affect a member's benefit;
- the example to be included in the PDS is based on single account balance (namely, $10,000) and could be misleading as it potentially advantages funds charging on a rising scale as opposed to funds charging a flat amount; and
- superannuation fund earning rates have to be presented net of investment expenses which could result in double counting of these expenses in the total OMC.[5]

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3 Submission 23, p. 3.

4 Pamela McAlister, *Committee Hansard*, 23 May 2002, p. 27.

5 Submission 5, p. 6.

6.11 In support of its claims about the difficulties posed by the OMC, ASFA provided the results of initial consumer testing which it commissioned Ageing Agendas to conduct. The survey tested consumers' comprehension of OMCs in two fictitious Product Disclosure Statements and indicated that only 10 per cent of those tested were able to answer 90 per cent of questions correctly.[6] ASFA has advised that this survey is the first in a series which will test various disclosure measures.

6.12 Rainmaker Information Pty Ltd (Rainmaker) commented that difficulties in prescribing meaningful disclosure requirements were attributable partly to the differing terminology used by superannuation funds to describe their fees and the distinction made between fees charged to members and fund costs. With regard to the latter, Rainmaker said that, while disclosure tended to refer to fees, it did not refer explicitly to fund costs, which themselves were important because they affected members' returns. The comment was made that:

> Rainmaker has found that the subtle distinction between these notions [of costs and fees] can lead to ambiguities because a superannuation fund can claim it has no fees simply because all its costs are paid by the overall fund. In some cases this can cause tremendous difficulty in assessing the true picture of how much a member is really paying for their superannuation. Indeed, Rainmaker believes that from an investor's perspective there is really no material difference between fees and costs.[7]

6.13 At the hearing on 23 May 2002, Mr Alex Dunnin, Director of Research for Rainmaker, noted that the OMC did not include contribution charges and said that, from a consumer's perspective, this was an important omission. Mr Dunnin commented that it was possible to create a conceptual framework from which dollar amounts for fees could be calculated without too much difficulty.[8]

6.14 Rainmaker suggested that the OMC should be amended:

- to include contribution charges and fund costs as well as fees;
- to provide definitional guidelines of what constituted a fund cost or expense and what constituted gross earnings from which fees and costs were deducted; and
- to state clearly whether any hypothetical examples given were likely to produce distortions.[9]

6.15 Mr Dunnin commented that he did not favour the use of the Management Expense Ratio (MER) because, for multi-optioned retail products, the MER usually

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6 The Committee understands that the results of this survey (dated September 2002) had not been made public at the time of writing this report.

7 Submission 21, p. 5.

8 *Committee Hansard*, 23 May 2002, pp. 49–53.

9 Submission 21, p. 9.

only reflected investment management costs which might only be a quarter of the total costs paid by a consumer.[10]

6.16 The Investment and Financial Services Association (IFSA) was supportive of the OMC. With regard to the utility of the MER, Mr Richard Gilbert, Chief Executive Officer, said that:

> …this industry has used a thing called a management expense ratio for the best part of the last 15 years, and I do not think anybody has been able to say that it has not been a good comparator between funds. Except for one difference, the management expense ratio essentially is the same as the OMC, and that one difference now is investment management charges…The MER is a worldwide best practice measure to compare funds. In looking at some web sites I noticed that the Canadians and the US have that particular model. We support the OMC because it has worked for us in the old superannuation regime…It does what it says it is going to do: it is the ongoing management charge. It is not the charge going into a fund or the charge going out of a fund; it is the charge of staying in a fund.[11]

6.17 IFSA argued that the OMC was appropriate because it applied to all people in a fund whereas entry and exit fees could be applied selectively depending upon a person's circumstances. IFSA commented that the $10,000 was 'a good illustration of an average superannuation investor'.

6.18 At the Senate Economic Committee's Consideration of Budget Estimates Hearing on 6 June 2002, the OMC was a subject of discussion. An officer from the Department of the Treasury said the OMC was intended to give a broad indicator to enable comparison of funds on a general but not individual level and acknowledged that the OMC was not a total expenses ratio.[12]

6.19 At the Committee's hearing on 7 August 2002, officers from the Department of the Treasury commented that the OMC was an enhanced version of the MER which had been prescribed under the *Superannuation Industry (Supervision) Act 1993* (SIS Act). The Department advised that the enhancements comprised:

- an indicative dollar amount;
- a breakdown of investment-related and non-investment-related management charges; and
- underlying investment costs associated with outsourcing.[13]

6.20 With regard to the issue of whether the OMC had been sufficiently consumer tested, the Department advised that it had consulted with about 40 different

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10 *Committee Hansard,* 23 May 2002, p. 52.

11 *Committee Hansard,* 7 August 2002, p. 252.

12 Susan Vroombout, *Committee Hansard*, 6 June 2002, p. 564.

13 Brett Wilesmith, *Committee Hansard,* 7 August 2002, p. 257.

stakeholders, including a number of consumer organisations. The Department further advised that, although one consumer group had opposed additional prescription for disclosure, no other consumer groups had opposed the OMC model per se. The Department commented that the focus of debate during consultation had been on the quantum of the dollar amount example provided in the OMC rather than its other features.[14]

6.21 In a recent report on disclosure commissioned by ASIC, Professor Ian Ramsay commented on the similarities between IFSA's MER and the OMC prescribed in the FSR regulations and noted that the key difference was that the latter also included expenses a direct investor would incur. With regard to the utility of the 'OMC/MER', Professor Ramsay's view was that:

> …it is typically recognised that the OMC/MER provides useful information relating to relative costs across similar funds and can identify trends in relation to ongoing management charges and expenses over time. It is to be noted that similar operating expense ratios are used in other countries such as Canada, New Zealand and the United States…[15]

6.22 Professor Ramsay concluded that an OMC should be used as an expense measure across all products including superannuation and other investment products. He expressed doubts about the use of a single global figure in lieu of the OMC and said that, while it might have initial attractions, a number of important fees would still have to be disclosed separately. These would generally include entry and exit fees whose application or quantum might be discretionary.[16]

6.23 In its media and information release on Professor Ramsay's report, ASIC commented that:

> The report will facilitate further consultation by ASIC with industry and consumer representatives about the future direction of disclosure for investment products under the FSRA regime.[17]

6.24 Given that his is the only independent report on the issue of fee disclosure, the Committee gives considerable weight to Professor Ramsay's conclusions.

The Committee's views

6.25 The Committee believes that because of the special features of superannuation—it is compulsory, attracts tax concessions and importantly has to be

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14 *Committee Hansard*, 7 August 2002, pp. 258–59.

15 Ramsay, *Disclosure of Fees and Charges in Managed Investments, Review of Current Australian Requirements and Options for Reform,* released 25 September 2002, p. 205.

16 *Disclosure of Fees and Charges in Managed Investments,* p. 198.

17 ASIC Media and information release 01/352 *ASIC releases Ramsay Report on disclosure of fees and charges,* 25 September 2002.

preserved—it is desirable that consumers have appropriate tools to compare funds to assist them in choosing the right one for them.

6.26 The Committee notes IFSA's comments that the MER, on which the OMC has been based, has been used by the superannuation industry for some years under the old legislation. It further notes Professor Ramsay's comments about the MER and OMC.

6.27 The Committee appreciates the difficulties involved in developing a 'one-size-fits-all' disclosure formula to assist comparability across funds. With this in mind, the Committee makes the following recommendation:

Recommendation

The Committee recommends that:

- **ASIC and the Department of the Treasury work together to continue the momentum generated by ASIC's initial investigations into the disclosure of fees and charges for investment products[18] to produce guidelines for a leading-edge, consumer-friendly superannuation fee disclosure model that will facilitate comparability of funds; and**
- **upon the development of an appropriate disclosure model, ASIC should publish details in a guide for use by the superannuation industry. ASIC should also alert consumers to the advantages of the model and provide working notes.**

Insurance

Commission on risk products

6.28 Financial services licensees and their authorised representatives are required under the *Corporations Act 2001* to provide certain information to retail clients in the Financial Services Guide (FSG) and Statement of Advice (SOA). Both documents require disclosure of commission.

6.29 With PDSs, disclosure of commission is only required if the commission may or will impact on the amount of the return generated by the financial product.[19]

6.30 The Explanatory Memorandum for the *Financial Services Reform Act 2001* (FSR Act) explains why commission on risk products does not have to be disclosed in the PDS:

> The purpose of commission disclosure at point of sale of the product is to enable the client to assess the likely return on the product. In order to do

18 These initial investigations refer to Professor Ramsay's report into fees and charges which ASIC commissioned: *Disclosure of fees and charges in managed investments, review of current Australian requirements and options for reform,* released on 25 September 2002.

19 Paragraph 1013D(1)(e) of the *Corporations Act 2001*.

> this, [the legislation] requires commissions, or other similar payments, to be disclosed to the extent that they will ultimately impact on the return that the holder of the product will receive.
>
> …For the most part, when a consumer purchases a risk insurance product they pay a premium in order to insure against a future risk…Even though the premium the consumer pays includes a portion that will ultimately be paid to the financial service provider as commission, the payment of the commission will not affect the amount paid if the event occurs. [20]

6.31 The Financial Planning Association of Australia Limited (FPA) was critical that the disclosure of commission at PDS level was not uniform under the FSR Act. The FPA said that, as the PDS was effectively a marketing tool, there should be a requirement for disclosure of commission on all financial products.[21] More specifically, the FPA submitted that where risk products were offered as part of a package with an investment product, the return on the investment product could be artificially raised by loading up the commission on the risk product component.[22]

6.32 A contrary view expressed by the Association of Financial Advisers (AFA) at the hearing on 23 May 2002 was that, while members supported the disclosure of commission where this affected the end benefit, they did not support disclosure where commission had no such effect. The AFA argued that for trauma or income protection insurance, the client's premium and end benefit would be the same regardless of the commission paid. Furthermore, they contended that consumers were not interested in having commission payments disclosed to them.[23] The views of the AFA were also reflected in the submission and evidence given by Mr Michael Murphy from Murphy Financial Services (SA) Pty Ltd.[24]

The Committee's views

6.33 The Committee considered the issue of commission on risk products during its two previous inquiries into the financial services reform legislation and concluded that:

- cost and service—not commission—were the primary influences on consumers of risk products; and
- a disclosure requirement for risk products would be particularly detrimental to small business operators.

6.34 The Committee consequently recommended against disclosure of commission on risk products and does not depart from this position in this report. The legislation

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20 Financial Services Reform Bill 2001, Explanatory Memorandum, Parliament of the Commonwealth of Australia, House of Representatives, p.148.

21 *Committee Hansard*, 11 July 2002, pp. 127–28; Submission 4, p. 2.

22 Submission 4, p. 2.

23 *Committee Hansard*, 23 May 2002, p. 38.

24 Submission 13; *Committee Hansard*, 23 May 2002, pp. 35–48.

and regulations partly reflect this position in not requiring disclosure of commissions in PDSs, although requiring it in the FSG and SOA.

6.35 The Committee accepts this and recommends that there be no changes to the present requirements. The Committee notes, however, the comments made by the FPA about the potential loophole created by the concession for the loading up of commissions in some circumstances. While the Committee is concerned that there may be potential for such a practice, the Committee considers that it would be premature to recommend any action at this stage.

6.36 Although not strictly within the terms of reference for this inquiry, the Committee believes consideration of this issue is appropriate because of the potential adverse effects a change in the legislation could have on small business operators. Furthermore, the Committee notes that this issue ties in with others affecting life insurance agents who are having to adapt to changes within their industry indirectly arising from the new regulatory regime. These are discussed in Chapter 9.

Unauthorised foreign insurers

6.37 The National Insurance Brokers' Association of Australia (NIBA) referred to certain disclosure provisions that had been carried over to the FSR Act from the *Insurance (Agents and Brokers) Act 1984* (IABA). NIBA said these provisions required certain disclosures to be made for insurance placed with unauthorised foreign insurers and raised concerns that the FSR Act required disclosure only to retail clients and not also to wholesale clients as had been the case under the IABA.[25] Specifically, the requirements entail:

- providing warnings in relation to dealing with an unauthorised foreign insurer;
- providing details of the insurer with whom the broker is dealing and client is contracted; and
- disclosing various associations with insurers and disclosing binder arrangements with insurers.

6.38 In addition, NIBA said the IABA provision which required insurance intermediaries to lodge information with ASIC about insurance placed with unauthorised foreign intermediaries had also been discontinued under the FSR legislation.

6.39 NIBA urged that the Committee recommend their reinstatement through regulations made under section 949B of the FSR Act.

6.40 In support of NIBA's argument that the unauthorised foreign insurer disclosure obligations were just as pertinent for wholesale as for retail clients, Mr John Hanks, Consultant for NIBA, commented that the rationale for the limitation to retail clients appeared to be that '[wholesale] people were big enough to look after

25 Submission 33.

themselves'. He queried this and suggested that the retail/wholesale distinction for risk insurance was not the same as the retail/wholesale distinction that might exist for other financial products.

6.41 In this regard, he commented that:

> You do not have to be a very large player to be classified as a wholesale person purchasing insurance…A small businessman insuring his own property or his liability would be classified as wholesale…At the present time there is a difficult insurance market. People are being forced to look overseas for their insurances because they just cannot buy in Australia: it is difficult or the price is not right. We are seeing more and more people looking at purchasing overseas… [Retail insurances] are not the insurances that people are going overseas to purchase.[26]

6.42 While NIBA acknowledged that some unauthorised foreign insurers were reputable, it was concerned with the growing trend for wholesale consumers to seek insurance from overseas insurers because of problems in the domestic market. Although not able to provide statistics relating to the quantum of wholesale insurance that was purchased through offshore providers, NIBA said that the figure was not inconsequential.

6.43 NIBA commented that it would not be an imposition on intermediaries to require them to make the relevant disclosures to both retail and wholesale clients as this would merely involve the continuation of requirements that had existed under the IABA for the previous 15 to 20 years.

6.44 With regard to the discontinuance of reporting to ASIC, NIBA argued that this requirement should be re-instated because such information was vital for the effective monitoring of insurance in Australia particularly given the increasing use of unauthorised foreign insurers.

The Committee's views

6.45 The Committee accepts that NIBA's concerns are well-founded and agrees that a continuation of the disclosure and reporting practice originally required under the IABA would not represent an unreasonable imposition on the insurance industry.

6.46 The Committee therefore makes the following recommendation:

Recommendation

The Committee recommends that regulations be made to continue the existing provisions in the *Insurance (Agents and Brokers) Act 1984* with application to wholesale clients in addition to retail clients regarding:

- **dealing with unauthorised foreign insurers;**

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26 *Committee Hansard*, 12 July 2002, pp. 232–33.

- **providing details of the insurer;**
- **disclosing an association with an insurer; and**
- **disclosing binder arrangements with insurers.**

Recommendation

The Committee also recommends that ASIC be empowered to collect information about licensees dealing with unauthorised foreign insurers as was the case under the *Insurance (Agents and Brokers) Act 1984.*

6.47 The Committee believes that these amendments by way of regulation will be consistent with the consumer protection objectives of the FSR Act.

CHAPTER 7

Issues affecting Australia as an international financial centre

Introduction

7.1 Corporations regulation 7.6.10(n) provides for a licensing exemption to offshore providers of financial services under specified conditions. The regulation has attracted criticism from a number of submitters on the basis that the restriction of the exemption to 'dealing' only is neither workable nor appropriate.

7.2 With regard to the second issue, concerns have been raised about how ASIC will exercise its discretion to approve overseas regulatory authorities under paragraph 911A(2)(h) of the *Corporations Act 2001* (the Act).

Exemption from licensing—offshore service providers

7.3 Section 911A of the Act provides that a person who carries on a financial services business in the jurisdiction covered by the Act must hold an Australian financial services licence. Exemptions from the licensing requirement may be specified in the regulations.

7.4 Regulation 7.6.01(n) provides a licensing exemption for persons outside the jurisdiction covered by the Act ('offshore providers') who 'deal' in financial products under certain circumstances. Specifically, the regulation states that offshore providers will not have to be licensed to provide financial services consisting of dealing in a financial product to a person within the Act's jurisdiction on condition that the service is arranged by a licensee whose licence covers the particular service provided.

7.5 Offshore providers wishing to provide financial services other than dealing will be required to obtain a financial services licence.

7.6 The International Banks and Securities Association of Australia (IBSA), Goldman Sachs Australia Pty Ltd (Goldman Sachs), Morgan Stanley Dean Witter Australia Securities Limited and Morgan Stanley Dean Witter Australia Limited (Morgan Stanley) raised concerns about regulation 7.6.01(n).[1]

7.7 The submitters said that they supported the original draft regulation released for consultation and noted that it applied to the provision of financial services generally and was not restricted merely to dealing. They also said it was similar to repealed subsection 93(5) of the Corporations Law and that this provision had worked well.

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1 Submissions 19, 26 and 30 respectively.

7.8 Their major concern was with the amendment of the regulation to restrict the licence exemption to dealing only. However, they were also critical of the consultation process for the regulation and claimed they were not given the opportunity to comment on the change, nor were they aware that such a change would be made.

7.9 IBSA commented that the Department of the Treasury was concerned that the regulation, as originally drafted, would provide a means for financial services providers to move offshore and avoid FSR regulation.

7.10 The submitters claimed that the narrowing of the regulation's coverage had resulted in difficulties of application. Goldman Sachs provided the following examples:

> …the activity of issuing OTC derivative products is 'dealing'. However, there is a point in the development of a successful business of dealing in OTC derivative products at which clients start to have an expectation that, should they call, they will be quoted a price. At that point, the activity may be 'market making' to which regulation 7.6.01(n), in its final form, does not apply. The point at which 'dealing' becomes sufficiently successful to be 'market making' is indistinct, which is problematic in relation to the operation of Regulation 7.6.01(n). A similar problem may also exist in relation to the indistinct point at which 'arranging' (which is categorised by the Act as 'dealing' and is therefore covered by Regulation 7.6.01(n)) becomes 'advising', which is not covered by Regulation 7.6.01(n).[2]

7.11 In the same vein, Morgan Stanley commented that:

> There appears to be no logical explanation for this limitation considering that advice and dealing services are often intertwined, and the difficulty in differentiating between dealing and market making activities. In addition, custodial services will often be provided as part of the suite of services to the client.[3]

7.12 More generally, IBSA claimed that the limitations in the regulation would adversely affect the delivery of financial services to the Australian market by offshore service providers. In this regard, IBSA said that:

> It is often found that those most familiar with local market conditions and regulatory requirements are qualified persons located in the jurisdiction in which the investment is undertaken.
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> In the event that correspondent offshore providers must be licensed in Australia, Australian investors may be disadvantaged, as these providers are unlikely to continue to offer their services. One reason for this is the unfavourable balance between the compliance cost of regulation for a global

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2 Submission 26, p. 2.

3 Submission 30, p. 6.

> bank and the benefit from servicing Australian clients, who as a group are relatively small in global business terms. This in part reflects the practical difficulty of having to comply with Australian regulation, as well as their home regulation given the scope and complexity of their overall business.[4]

The Committee's views

7.13 The Committee notes IBSA's comments about the Department of the Treasury's possible reasons for limiting the regulation to 'dealing', namely, that a more widely framed provision might prompt institutions to move their financial services businesses offshore and so avoid FSR regulation. Although IBSA has argued that the Australian-based licensee arranging the provision of the offshore services would still have to satisfy the requirements of FSR regulation, the Committee has concerns that retail consumers could be disadvantaged, particularly in the area of financial advisory services.

7.14 Notwithstanding the Committee's concerns, the Committee accepts that there may be practical difficulties in the application of regulation 7.6.01(1)(n) because of the potential for overlap between 'dealing' and 'market making' and 'arranging' and 'advising'.

Recommendation

The Committee consequently recommends that regulation 7.6.01(1)(n) be reviewed as soon as possible with the objective of resolving the difficulties involved in its practical application and so make it consistent with the regulatory objective of enhancing efficiency in the provision of financial products.

7.15 As far as widening the scope of the regulation is concerned, the Committee notes that subsection 93(5) of the repealed Corporations Law (on which the submitters suggested regulation 7.6.01(1)(n) should be modelled) only applied in the context of a securities business. It further notes that regulation 7.6.01(1)(n) provides for dealing in financial products which has a wider scope than the notion entailed in a securities business. The Committee consequently considers that, assuming the practical difficulties in the regulation are resolved, the regulation represents an acceptable regulatory compromise between the old and the new FSR regimes.

Cross-border financial services

7.16 Paragraph 911A(2)(h) of the Act provides that a person regulated by an overseas regulatory authority that is approved by ASIC in writing may provide those regulated financial services to wholesale clients without having to obtain an Australian financial services licence.

7.17 At the hearing on 11 July 2002, Dr David Lynch, Director of Policy at IBSA, said that ASIC had held a round-table meeting with industry in early June to discuss

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4 Submission 19, p. 3.

proposals raised in ASIC's consultation paper on cross-border financial services which had been released in May 2002. Dr Lynch referred to the following as the key issues that emerged at the meeting and were still awaiting resolution:

- who would ASIC recognise as an approved overseas regulator?
- what range of activities would ASIC recognise as being regulated?
- ASIC's timeliness in finalising its conclusions on the previous two issues.[5]

7.18 IBSA, Goldman Sachs and Morgan Stanley raised concerns that ASIC would adopt what they regarded as too narrow an approach in the assessment of overseas regulation with the emphasis being on identifying symmetries in regulatory approaches rather than looking at their substance.

7.19 On this point, Goldman Sachs said it raised issues with ASIC about its consultation paper that related to, among other things:

> …the potential imposition by ASIC of a requirement for overseas providers to disclose differences between the overseas regulatory regime and the Australian regime, which would entail a very substantive comparative analysis of two (probably sophisticated) legal systems.[6]

7.20 Also on this point, IBSA commented at the hearing that:

> One of the difficulties with looking at the detail of the law is that the regulatory system here is quite different to those in other jurisdictions, so you are not going to get symmetry or a mirror effect. I will give an example. The insider trading laws in Australia, as introduced through the act, cover all OTC transactions. That is typically not the case in most other jurisdictions. So if the expectation in looking at similar regulatory regimes was that you would have precisely the same outcomes, you would never get anybody to recognise that. There needs to be a pragmatic approach which looks at the substance of the regulation and, to some degree, the quality of the regulation as well as the specific design of it.[7]

7.21 Timeliness was another issue raised in the submissions. All argued that it was important for ASIC to progress its assessments of overseas regulators as soon as possible to enable financial services groups to complete their transition planning. It was suggested that it might be most efficient for ASIC to conduct its initial assessment on regulators from the major financial centres such as the United Kingdom, the United States, Japan, Hong Kong and Singapore.

7.22 Referring to these issues, Morgan Stanley commented that:

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5 *Committee Hansard,* 11 July 2002, p. 209.

6 Submission 26, p. 2.

7 *Committee Hansard*, 11 July 2002, p. 212.

> Whilst ASIC is encouraging financial service providers to transition early, groups such as Morgan Stanley are experiencing difficulties in completing their transition planning, even before beginning to transition to the new regime, until ASIC identifies which overseas regulators will be approved for the purposes of section 911A(2)(h). This is an even greater problem for suitably regulated foreign entities which do not have the benefit of the transition period for all or part of their business because they wish to either expand their activities or commence business in Australia.
>
> Accordingly, regulators should be approved under the exemption as a matter of urgency. Morgan Stanley endorses (and contributed to) the IBSA recommendation of 10 May 2002 that ASIC initially focuses on the major global financial centres (e.g. the United Kingdom, the United States, Hong Kong, Singapore and Japan).
>
> ASIC has previously stated that it will consider individual applications for ASIC to approve foreign regulators in respect of specific services. Morgan Stanley submits that a far more effective approach in light of the urgency of the matter would be for ASIC to approve at least some of the major foreign regulators, including the United States Securities and Exchange Commission and the United Kingdom Financial Services Authority.[8]

The Committee's views

7.23 ASIC has advised the Committee that it has not yet developed any definite policies for the regulation of cross-border financial services. However, it has indicated that the consultation paper discussed by the submitters was comprehensively circulated and discussed with all stakeholders and foreign regulators in Hong Kong, Singapore, New Zealand and the United Kingdom.

7.24 The Committee notes ASIC's advice that:

> …ASIC is currently in the process of taking all comments received into account before issuing a final document version of the 'Principles of cross-border regulation', sometime next month. The principles will be high-level and intended to guide ASIC's decision making and policy making processes before progressing to develop relevant and more specific policy on cross border situations.[9]

7.25 The Committee also notes that ASIC recently advised in its 'Frequently Asked Questions' segment on its website that it plans to release its final policy on overseas regulators as well as overseas regulated financial services providers generally in the second quarter of 2003, with policy proposal papers scheduled for release in the last quarter of this year.

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8 Submission 30, p. 2.

9 Letter dated 16 August 2002 to the Committee from Mr Andrew Larcos, Government Relations Adviser, ASIC.

7.26 The Committee draws some comfort from the fact that ASIC will consider applications for interim relief:

> We recognise that some financial service providers may not be able to take advantage of the two-year transition period; such as providers wishing to commence business in Australia for the first time after 11 March 2002 or established providers wishing to undertake new classes of activities after 11 March 2002. Further, we also recognise some established providers may wish to rely on some form of exemption for overseas financial service providers during the transition period.
>
> Until our final policy is released we are prepared to give interim relief on a case-by-case basis to such financial service providers.[10]

7.27 However, the Committee is concerned that ASIC's timetable for formulation of its policy regarding overseas regulators may not be in keeping with industry's expectations or needs, notwithstanding the availability of interim relief.

Recommendation

The Committee urges ASIC to reconsider its timetable with a view to expediting its policy formulation for the regulation of cross-border financial services following the consultation process.

7.28 In terms of the actual content of ASIC's policy statement and the approach it adopts in assessing overseas regulators, the Committee is not persuaded on the evidence that the Committee's intervention at this early stage would be appropriate.

10 *Frequently Asked Questions*, ASIC website, www.asic.gov.au, 29 August 2002.

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…
>
> …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.

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.
>
> …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.

CHAPTER 10

Miscellaneous issues

Anti-hawking

10.1 The Financial Planning Association of Australia Limited (FPA) and the Australian Bankers' Association (ABA) were critical of the anti-hawking provisions in the *Corporations Act 2001* (the Act).[1]

10.2 One of their criticisms was that the provisions failed to clarify when the nexus between the unsolicited personal contact and the offer to issue or sell a financial product had been broken. In particular, this related to the interpretation of 'because of' in the provision.

10.3 The ABA also argued that the provisions drew no distinction between unsolicited contacts where there was no existing customer relationship and those where there was. It referred to an example where a bank might telephone an existing customer before a term deposit was due to mature and ask the customer for instructions on reinvestment upon the maturity of the deposit. The ABA said that while this approach benefited the customer, it would still be an unsolicited contact.

10.4 The Committee accepts the criticisms made by the FPA and ABA about difficulties in the interpretation of the anti-hawking provisions. However, it notes that ASIC has recently addressed the most commonly raised difficulties with the provisions in its recent publication, *The hawking provisions—an ASIC guide*. The Committee further notes that the questions raised by the FPA and ABA are clarified in ASIC's guide.

10.5 Freehills commented that the 'no contact' rules in subsection 992A(3) appeared to apply to both managed investments and other financial products whereas section 992A in its entirety appeared not to apply to managed investments. Freehills suggested that regulations should clarify this.[2]

10.6 In relation to Freehills' comments, the Committee notes ASIC's Class Order 02/641 *Hawking—securities and managed investments* issued on 31 May 2002. This clarifies that section 992A as a whole does not apply to securities or interests in a managed investment scheme.

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1 Submissions 4 and 22 respectively.

2 Submission 7, p. 3.

Anti-hawking—cold calling

10.7 On 18 June 2002, Senator Stephen Conroy gave notice to disallow the regulation prescribing the times during which financial services licensees were permitted to telephone consumers (the cold-calling hours). The disallowance motion was withdrawn on 16 September 2002.

10.8 At the hearing on 7 August 2002, the Committee sought information from the Department of the Treasury regarding its amendments by regulation to the times when financial services licensees could telephone consumers (the cold-calling hours). The Department responded that:

> We received several submissions on the early draft on the cold-calling hours. Those submissions suggested that there did not seem to be any reason why the government should adopt hours that differed from the accepted industry standard for direct marketing, which were agreed by state and federal ministers.[3]

The Committee's views

10.9 The Committee notes that paragraphs 992A(3)(a) to (e) impose the following limitations on unsolicited telephone calls to ensure consumers are adequately protected:

- the person cannot be contacted if he or she is listed on a 'No Contact/No Call' register;
- the person must be given an opportunity to be placed on the register and select the time and frequency of future contacts;
- the person must be given a Product Disclosure Statement (PDS) before becoming bound to acquire a financial product and must be clearly informed of the importance of using the information in the PDS; and
- the person must be given the option of having the information in the PDS read out to him or her.

10.10 In addition, subsection 992A(4) provides the consumer with a right of return and refund within certain limits where there has been a breach.

10.11 Finally, the Committee notes the protection offered by the legislative prohibitions on unconscionable conduct, misleading or deceptive conduct and harassment or coercion.[4]

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3 *Committee Hansard,* 7 August 2002, p. 256.

4 See sections 12CA-12CC of the *Australian Securities and Investments Commission Act 2001* (ASIC Act) and section 991A of the *Corporations Act 2001*—unconscionable conduct; sections 12DA-12DB of the ASIC Act and sections 1041E–1041H of the Act—misleading or deceptive conduct; and section 12DJ of the ASIC Act—harassment or coercion.

10.12 In the circumstances, the Committee is not persuaded that the regulation adopting the direct marketing industry standard for cold-calling should be amended. The Committee is satisfied that there are sufficient consumer protection mechanisms in place.

Telephone monitoring of takeovers

10.13 Following significant opposition to the telephone monitoring provisions inserted into the Financial Services Reform Bill 2001, the Committee, in its report on the Bill tabled in August 2001, recommended that the Government should remove the provisions and consider other regulatory options. This recommendation was not followed.

10.14 During the current inquiry, the International Banks and Securities Association of Australia (IBSA) submitted that:

> …we believe that the takeovers telephone monitoring provisions in the FSR Act are defective…and should be struck out…There is no discernible public benefit from this addition to one of the most highly regulated parts of securities business, while the associated costs are significant.
>
> The general policy objective would be to improve the flow of information to retail shareholders during the takeover period. However, the telephone monitoring provisions in the Corporations Act are counterproductive for small shareholders, as at least some banks are restructuring their operations to minimise contact with them that might involve a requirement to tape calls during takeovers. This is being done to avoid the legal complexities and operational costs of complying with the recording requirement.[5]

10.15 While IBSA conceded that the regulation 6.5.01 went some way towards improving the application of the main provisions, it claimed that regulations could not ameliorate the flawed framework of the law itself. The flaws identified by IBSA were that the Act:

- was inconsistent in its coverage—provisions only covered telephone calls during the bid period and not during the period between the announcement of a bid and service of the bidder's statement in an off-market bid;
- did not clarify what might constitute an 'invitation' to shareholders to call to discuss a bid;
- imposed prescriptive and impractical recording requirements that would entail significant cost; and
- failed to take into account that it was not possible to record calls made to shareholders on mobile phones.

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5 Submission 19, p. 4.

The Committee's views

10.16 The Committee appreciates that this issue does not fall squarely within its terms of reference. However, the Committee agrees that the provisions in the Act, notwithstanding the modifying effects of regulation 6.5.01, need to be revisited to determine whether they are imposing requirements on industry without an equivalent benefit to consumers.

Recommendation

The Committee recommends that the Government review the telephone monitoring provisions with a view to removing them from the Corporations Act altogether.

Inconsistencies and navigational challenges in the legislation

10.17 A recurring comment in submissions and evidence given at the hearings was that the Act and regulations presented quite significant 'navigational' challenges which would inevitably lead to increased costs for consumers. Inconsistencies between the Act and the regulations were also referred to.

10.18 With regard particularly to the navigational difficulties presented by the legislation, the Australian Stock Exchange Limited (ASX) commented that:

> We note that the structure of the Act and Regulations at present makes full comprehension of relevant concepts in the Act difficult and may result in users not applying all relevant provisions. For example it is hard to navigate the regulation regarding insider trading provisions where some significant provisions are made through modification provisions, located in different parts of the Act, as opposed to being included in regulations with other insider trading provisions. Such a disjointed approach makes full comprehension of provisions in the Act unwieldy. Perhaps at a later stage of review consideration could be given to including notes to the regulations with relevant cross-references.[6]

10.19 IBSA identified what it considered were shortcomings in the interaction between the Act and regulations. These were that:

- while the Act was intended to set a broad framework within which the regulations would 'flesh out' the detail, this was not always the case. The result was that the regulations represented a level of detail superimposed on already detailed legislation;
- the application of the Act and the regulations was not always consistent and created confusion and uncertainty; and

6 Submission 15, p. 3.

- the regulations in combination with sections of the Act could override other sections of the Act for all purposes which called into question why the Act itself was not amended.[7]

10.20 At the hearing, on 23 May 2002, Freehills commented that the complexities of the legislation would lead to increased operational and regulatory costs in the financial services sector which would ultimately be passed on to consumers.[8]

The Committee's views

10.21 While the Committee accepts the comments made about the practical difficulties posed by the legislation as a whole, the Committee nonetheless considers that the complexity and volume of the regulations is to some degree a reflection of their function, namely, to provide the detail for the extensive regulatory framework created by the FSR Act. However, the Committee agrees that there are inconsistencies and anomalies that should be addressed.

10.22 In this regard, the Committee notes that the Department of the Treasury continues to 'fine-tune' the legislation as problems and inconsistencies are identified. The Committee is satisfied that this more evolutionary process is preferable to a wholesale re-arrangement or overhaul and is not persuaded that the Committee's intervention at this stage is necessary. It does, however, take this opportunity to underline the need for legislation, as far as possible, to be user-friendly and accessible to all members of the community.

10.23 The Committee notes in particular the suggestion by the ASX that 'notes to the regulations with relevant cross-references' would be helpful.

Matters outside the inquiry's terms of reference

10.24 As noted earlier, a number of difficulties with the Act were referred to during the course of the inquiry. As these fell outside the inquiry's terms of reference, the Committee did not examine these. The main areas of concern were whether:

a) the drafting of section 916B would have unintended payroll tax consequences;

b) it was appropriate for the disclosure obligations regarding units in listed trusts to be different from those applying to securities;

c) there were problems with the implementation of the cooling off and transaction confirmation provisions for investor directed portfolio services because of features not contemplated by the legislation;

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7 Submission 19, p. 6.

8 *Committee Hansard*, 23 May 2002, pp. 21–22.

d) the on-sales disclosure requirements in subsections 707(3) and (4) and 1012C(6) and (7) of the Act were proving difficult to interpret and implement.

10.25 The Committee notes that, with regard to the on-sale disclosure provisions referred to, ASIC released a discussion paper on 28 June 2002 to examine proposals for ongoing relief from these provisions. The Committee further notes ASIC's comments that it is confident relief can be given from the provisions in certain circumstances without defeating their anti-avoidance legislative purpose.[9] Given ASIC's comments, it may be that this issue is capable of resolution without legislative intervention.

10.26 However, with regard to the other matters, the Committee considers that the Department of the Treasury may wish to pursue these.

Senator Grant Chapman
Chairman

9 ASIC's discussion paper is entitled, *Disclosure for on–sale of securities and other financial products*. The closing date for public comment was 8 August 2002. ASIC has extended the interim relief from these provisions to 11 December 2002 to allow time for consideration and comment on the proposals. See ASIC Media and information release 02/235 *ASIC releases discussion paper on disclosure for on-sale of financial products,* 28 June 2002.

REPORT BY THE LABOR MEMBERS

The Labor members of the Committee maintain their support for the objectives of the FSR Act. These reforms were to:

> "….put in place a competitively neutral regulatory system which benefits participants in the industry by providing more uniform regulation, reducing administrative and compliance costs, and removing unnecessary distinctions between products. In addition, it will give consumers a more consistent framework of consumer protection in which to make their financial decisions."[1]

However, as was stated by Labor when the FSR Bill was debated, the implementation of the new regime needs to be thoughtfully considered by the Government and the impact of the new regime closely monitored. This is particularly important given the large number of people who are likely to be required to be licensed under the *Corporations Act* for the first time.

Following the Committee's investigations, the Labor members have some concerns with the implementation of the FSR Act, which may affect the achievement of the objectives of the Act. The Labor members in particular wish to note to following concerns.

Disclosure of Fees and Charges

The Labor members note the evidence given to the Committee by the Australian Consumers Association (ACA), Freehills, the Association of Superannuation Funds in Australia (ASFA) and Rainmaker Information Pty Ltd. All of these organisations raised concerns with how meaningful the OMC would be to consumers and warned of its potential to mislead. These concerns have been summarised in the Chair's report.

The Labor members note subsequent consumer testing by ASFA which confirmed very poor results for the OMC and its ability to provide a useful tool for consumers. The Labor members also note that the OMC and the disclosure obligations in the relevant regulation had not been subject to consumer testing by the Government.

The Labor members also note the recommendations in relation to the OMC of Professor Ramsay in his report, Disclosure of Fees & Charges, released by ASIC on 27 September 2002. However, Professor Ramsay did not conduct any consumer testing on the effectiveness of the OMC.

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[1] Financial Services Reform Bill 2001, Explanatory Memorandum, Parliament of the Commonwealth of Australia, House of Representatives, p.1

The Labor members also wish to record that the relevant regulation prescribing additional disclosure requirements applied to superannuation products, and not to managed funds more broadly. This is inconsistent with the recommendations of Professor Ramsay in his report mentioned above, which supports a consistent and comparable disclosure regime across both superannuation products and managed funds.

The Labor members believe that the objectives of the FSR Act require that the disclosure requirements be consistently applied. Further, if consumers are to be provided with the information they need to make informed decisions, information on fees and charges must be provided to them in a way which is meaningful and allows comparisons across products.

The Labor members support the disallowance of regulations 7.9.10 and 7.9.11 – as decided by the Senate on 16 September 2002. The Labor Members recommend that the Government immediately begin re-drafting those regulations so that consumers receive the information they need to make informed decisions. The amended regulations must be subject to proper consultation and consumer testing before they are finalised.

Small Business

The Labor Members note the impact on small business operators in the financial services sector of the transition to the FSR regime.

An objective of the FSR Act was to reduce administration and compliance costs. It does not appear, however that small business operators are yet reap those benefits. Larger financial organisations do however, seem better equipped to move to the new regime and have raised few issues with the implementation of the FSR Act.

In this regard, the Labor members note the survey conducted by the Financial Planning Association (FPA) which found a very slow rate of transition to the new regime – particularly among small business operators - due likely to the heavy burden in effort, time and money.

The regulations and the implementation of the FSR Act by ASIC must have due regard to the disproportionate impact on small business, subject to not compromising consumer protection.

The Labor members are concerned that the new legislation is being used to unfairly discriminate against multi-agents. ASIC advised the Committee that:

> "..it was 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."[2]

The Labor members also note ASIC's suggestion that the concerns raised by multi-agents appeared to have a commercial basis, and not relate to regulatory issues.

The Labor members believe that some of the amendments made to the FSR Bill in the Senate – largely as a result of this Committee's report on that Bill – have provided some multi-agents with alternative and feasible options for operating under the new FSR regime.

The Government should however, consider whether further amendments are needed to deal with the outstanding concerns of some multi-agents. Further, where market power is being used to unfairly terminate a person's contract, or to force a person to enter the new FSR regime prematurely, it is appropriate that the ACCC investigate such matters and take any relevant enforcement action.

The Labor members are also concerned that the Government has not given sufficient attention to the taxation consequences of moving to the new FSR regime. The FPA advised the Committee that they had began negotiations with Treasury regarding the impact of capital gains tax when operations restructure to comply with the new regime.

The Labor members however are concerned that legislation has not yet been introduced by the Treasurer, and that the absence of the legislation may be discouraging people moving to the new regime. If this is the case, the time effectively available to transit will be much reduced and ASIC will find itself flooded with late applications for licenses and authorisations. This would not be a good outcome.

The Labor members urge the Treasurer to advise as soon as possible how the ATO is to treat capital gains that may arise when operations have to restructured to comply with the new FSR regime.

Basic Deposit Products

This Committee has examined before the treatment of basic deposit products under the FSR regime.

The Labor members continue to believe that basic deposit products have already received significant concessions under the new regulatory regime . The Labor members further believe that there will be significant benefits to consumers from requiring providers of basic deposit products to be competent to provide those services.

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[2] Committee Hansard, 7 August 2002, pp.277-278.

The Labor members do not therefore support any recommendation to exempt providers of deposit products from licensing under the Bill by excising deposit products from the definition of "financial product".

The Labor members do have some support for the Chair's alternate recommendations that ASIC review the training requirements in PS 146 and consider amending PS 146 in the manner recommended by the Chair, subject to not compromising consumer protection. The Labor members however, want to acknowledge the importance and benefits of a consistent standard for staff training across the financial services industry.

Under this heading, the Labor members also want to comment on two further matters in relation to basic deposit products. First, the Labor members want to reiterate their support for the full disclosure of all benefits and incentives that counter staff may receive or be offered in relation to the sale of financial products.

Second, the Labor members note the evidence obtained by the Committee in relation to the potential for staff dealing in basic deposit products to provide financial product advice when answering the questions of customers. The Labor members believe it is important that consumers receive financial product advice only from people qualified to provide that advice.

Accountants

The Committee has also previously examined the position of accountants under the FSR Act. Accountants who provide financial product advice should not be exempt from the operation of the FSR Act.

However, the Labor members believe it is appropriate to now consider how the implementation of the FSR Act is affecting the provision of accounting services.

It is clear that there is considerable uncertainty among accountants as to which of their services are subject to regulation under the FSR Act. The current drafting of regulation 7.1.29, in particular the subsection (2) of that regulation, does not assist accountants in their understanding.

The Labor members recommend that the Government redraft regulation 7.1.29 clearly identifying those activities which do not constitute financial product advice. Members of the Committee discussed some of those activities with the accounting professional bodies and that discussion should be utilised in determining those activities.

The Labor members are concerned that the Department advised the Committee on 7 August that:

> "At the moment the ball is largely in the accounting bodies' court. We are basically waiting for guidance from them about the sorts of specification and description of the types of activities they feel should be excluded."[3]

The Labor members hope that all parties can work constructively to provide certainty to the affected accountants. The Labor member further recommend that the Parliamentary Secretary to the Treasurer personally put in place a process for reaching an outcome as soon as possible. This will permit those accountants who may be required to be licensed or otherwise comply with the FSR regime to have the maximum possible time to transit to the new regime.

The Labor members also wish to make comment on the position of lawyers under the FSR Act. The statutory provision dealing with lawyers is subject to any activities that may prescribed in the regulations as constituting financial product advice.

Given the losses suffered by many investors in mortgage scheme previously operated by lawyers and supervised by law societies, the Government must maintain a vigilant oversight of what services lawyers are offering and where appropriate make regulations. In this regard, the Labor members draw to the Government's attention to the growing trend for solicitors to consider commission arrangements with suppliers of services to client, particularly loans and other financial arrangements.[4]

Miscellaneous

The Labor members note that the FSR Act was amended to regulate the times for, and manner of, unsolicited marketing by telephone of financial products. This was an amendment moved by Labor and has the continued support of the Labor members of this Committee.

The Labor members however, do not support the regulation specifying the hours for making unsolicited telephone calls. The breadth of the regulation is so broad as to undo considerably the intention of the statutory provision. The Labor members also do not accept that the hours for tele-marketing of financial products should be the same hours as for any other type of product.

Accordingly, the Labor members recommend that the Government amend the hours for making unsolicited telephone calls. As the disallowance motion dealing with this regulation has now been considered by the Senate, the Labor members will await the tabling of the amended regulation by the Parliamentary Secretary to the Treasurer.

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[3] Committee Hansard, 17 August 2002, pp. 260-261

[4] NSW Law Society Journal, February 2002

The Labor members also note the Chair's comments on spread betting. The Labor members do not wish to make any comment on the desirability or otherwise of spread betting.

However, the Labor members do not believe that the intention of Parliament in defining the word "derivative" in the FSR Act – and authorising ASIC to license providers of derivatives - was to override all State laws dealing with gambling. If that has been done, the Government should consider whether it is appropriate to amend the FSR Act to clarify the operation of the State laws.

Mr Alan Griffin MP **Senator Penny Wong**

Mr Anthony Byrne MP **Senator Stephen Conroy**

APPENDIX 1

SUBMISSIONS RECEIVED

1. Australian Chamber of Commerce and Industry
2. Australian Association of Permanent Building Societies
3. Institute of Chartered Accountants of New Zealand
4. Financial Planning Association of Australia Limited
5. The Association of Superannuation Funds of Australia Limited
6. Perpetual Trustees Australia Limited
7. Freehills

7A Freehills (supplementary submission)

7B Freehills (supplementary submission)

8. Bendigo Bank Limited

8A Bendigo Bank Limited (supplementary submission)

9. Credit Union Services Corporation (Australia) Limited

9A Credit Union Services Corporation (Australia) Limited (supplementary submission)

10. Derivatives.com.au Pty Ltd
11. Peter Davis Taxation & Accounting Services
12. The Institute of Chartered Accountants in Australia and CPA Australia
13. Murphy Financial Services (SA) Pty Ltd
14. Association of Financial Advisers

14A Association of Financial Advisers (supplementary submission)

15. Australian Stock Exchange Limited
16. National Institute of Accountants

16A. National Institute of Accountants (supplementary submission)

16B. National Institute of Accountants (supplementary submission)

17. Association of Mining and Exploration Companies (Inc)
18. AAMI Limited
19. International Banks and Securities Association of Australia
20. Australian Securities and Investments Commission
21. Rainmaker Information Pty Ltd
22. Australian Bankers' Association
23. Australian Consumers' Association
24. Boutique Financial Planning Principals Group Inc

25. Australian Finance Conference
26. Goldman Sachs Australia Pty Limited
27. Taxation Institute of Australia
28. Insurance Australia Group Limited
29. Corporate Superannuation Association Inc
30. Morgan Stanley Dean Witter Australia Securities Limited and Morgan Stanley Dean Witter Australia Limited
31. Australian Association of Agricultural Consultants Western Australia Inc
32. Trustee Corporations Association of Australia
33. National Insurance Brokers Association of Australia
34. National Tax & Accountants' Association
35. Investment & Financial Services Association Ltd
36. Confidential Submission
37. IG Index plc
38. Keith Harvey
39. National Online Trading Limited
40. Confidential Submission

APPENDIX 2

WITNESSES AT HEARINGS

Wednesday, 23 May 2002 – Melbourne

Derivatives.com.au Pty Ltd
Mr Michael Board, Director

The Association of Superannuation Funds of Australia Limited
Dr Bradley Pragnell, Principal Policy Adviser
Dr Michaela Anderson, Director of Policy & Research

Freehills
Professor Don Harding, Partner
Ms Pamela McAlister, Partner
Mr Ewan MacDonald, Senior Associate

Credit Union Services Corporation (Australia) Limited
Mr Adrian Lovney, General Manager, Public Affairs and Compliance
Mr Luke Lawler, Senior Adviser, Policy & Public Affairs

Association of Financial Advisers
Mr Joe Nowak, National President
Mr Dugald Mitchell, Consultant
Mr Michael Murphy (private capacity)

Rainmaker Information Pty Ltd
Mr Alex Dunnin, Director of Research

Australian Consumers' Association
Ms Catherine Wolthuizen, Senior Policy Officer, Financial Services

Australian Securities and Investments Commission
Mr Ian Johnston, Executive Director, Financial Services Regulation
Mr Malcolm Rodgers, Executive Director, Policy and Markets Regulation
Ms Pauline Vamos, Director, FSR Licensing and Business Operations
Mr Sean Hughes, Director, FSR Regulatory Operations
Mr Mark Adams, Director, Regulatory Policy

Thursday, 11 July 2002

Australian Bankers' Association
Mr Ian Gilbert, Director

Financial Planning Association of Australia Limited
Mr Ken Breakspear, Chief Executive
Mr Con Hristodoulidis, National Manager Policy and Government Relations

Australian Association of Permanent Building Societies
Mr Jim Larkey, Executive Officer
Mr Raj Venga, Director, Policy and Regulatory Affairs
Mr Derek Sams, Insurance Manager/FSR Committee, Heritage Building Society Ltd

Corporate Superannuation Association Inc
Mr Mark Cerce, Chairman
Mr Nicholas Brookes, Chief Executive Officer

National Institute of Accountants
Mr Reece Agland, General Counsel
Mr Gavan Ord, Technical Policy Manager

Taxation Institute of Australia
Mr Gil Levy, Senior Vice-President and Treasurer

The Institute of Chartered Accountants in Australia and CPA Australia
Mr Keith Reilly, Technical Adviser (ICAA)
Ms Kathy Bowler, Manager, Financial Planning (CPAA)

Peter Davis Taxation & Accounting Services
Mr Peter Davis, Principal

International Banks and Securities Association of Australia
Dr David Lynch, Director of Policy

Friday, 12 July 2002

Australian Finance Conference
Mr David Thorpe, Associate Director

Perpetual Trustees Australia Limited
Ms Gai McGrath, General Counsel & Company Secretary
Mr Michael Shreeve, National Director and Chief Executive Officer,
Trustee Corporations Association of Australia

National Insurance Brokers Association of Australia
Mr Noel Pettersen, Chief Executive Officer
Mr John Hanks, Consultant

Boutique Financial Planning Principals Group Inc
Mr Bruce Baker, President

Wednesday, 7 August 2002

Investment and Financial Services Association
Mr Richard Gilbert, Chief Executive Officer
Mr Philip French, Senior Policy Manager

Department of the Treasury
Mr Nigel Ray, Acting Executive Director
Mr Michael Rosser, Manager, Consumer Protection Unit
Ms Susan Vroombout, Manager, Market Integrity & Payments Unit
Mr Brett Wilesmith, Analyst, Consumer Protection Unit

Australian Securities and Investments Commission
Mr Ian Johnston, Executive Director, Financial Services Regulation
Mr Malcolm Rodgers, Executive Director, Policy and Markets Regulation
Ms Pauline Vamos, Director, FSR Licensing and Business Operations
Mr Sean Hughes, Director, FSR Regulatory Operations

APPENDIX 3

Letter to National Institute of Accountants from ASIC

Australian Securities & Investments Commission

Regional Office - Western Australia
66 St George's Terrace, Perth
GPO Box 9827 Perth WA 6001
DX 158 Perth

Telephone: (08) 9261 4000
Facsimile: (08) 9361 4010

Our Reference:
Your Reference:

5 July 2002

Reece Agland
General Counsel
National Institute of Accountants
PO Box 18204
MELBOURNE VIC

Dear Reece

I refer to your two letters of 2 July 2002 I attempt to address in this letter. Thank you for offering to assist ASIC in relation to providing feedback to the industry. Wherever possible ASIC utilises examples to deliver a clearer message to industry. We have found that in some instances examples cause more questions than they resolve as often they are interpreted to apply to that particular fact situation only.

Examples also fall within that fine line between providing guidance and legal advice. We need to be mindful that our examples may not cover the full fact situation and may provide misleading information to the industry.

ASIC welcomes the industry providing examples to its members. We find that the industry bodies are in a much better position to provide this service than ASIC. On this basis I would welcome the NIA to provide me with examples of situations it would like clarification on so I can seek internal feedback for you. They could then be placed by you on your website.

I am happy to meet with representatives of the National Institute of Accountants. I am currently located in Perth but am travelling regularly to the east coast. I am happy to arrange a phone hook up with you or meet with you on my next visit to the east coast which is in the last week of July. Please contact Emma Robinson on (08) 9261 4113 to arrange this.

I acknowledge that the definition of advice is broad. The focus of that definition is whether or not individuals are influenced in making a decision about a financial product because of a recommendation or opinion. The two examples you have provided in your letter in relation to superannuation and business advice do not necessarily amount to the provision of financial product advice. In particular most of the information that would be provided to the client in those situations would be in the nature of factual information and not necessarily amount to an opinion or recommendation in relation to a financial product.

You also raise an issue in relation to a "licence that will cover accountants". One Australian financial services licence can cover more than one financial service. As you would be aware there are five types of financial services that are covered by the Financial Services Reform Act. These include:

- The provision of financial product advice
- Dealing in a financial product
- Making a market
- Operating a managed investment scheme
- Providing a custodial service

Most accountants would be either advising or dealing in financial products or both. Their license would cover these services as well as the types of products they provide these services in relation to. It is irrelevant how they are paid for these services in relation to the licence. I am happy to discuss further with you the licensing process and what is required. For most accountants the cost would be minimal. We have developed the licenses so that they can be tailored as much as possible to the particular financial services.

I look forward to discussing this further with you when we meet or talk.

Yours sincerely

Pauline Vamos
Director
Licensing and Business Operations