AUSTRALIAN BANKERS' ASSOCIATION INC.

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Senator Grant Chapman
Chair, Parliamentary Joint Committee
on Corporations and Financial Services
Department of the Senate
Parliament House
CANBERRA ACT 2600
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Dear Senator Chapman,

Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007

On 24 May 2007, The Hon. Chris Pearce, Parliamentary Secretary to the Treasurer introduced the *Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007* and related bills into Parliament.

The bills include proposals to simplify and improve corporate and financial services laws, specifically in the areas of financial services, company reporting obligations, auditor independence, corporate governance, fundraising, takeovers and compliance.

The ABA welcomes the introduction of the Bill and commends the Government for its willingness to refine financial services and corporations regulation to address industry and consumer concerns. We have been working closely with the Government, Treasury and ASIC with a view to striking a better balance between costs for industry and protections for consumers. We therefore provide some targeted comments on those proposed legislative amendments which we believe require some further consideration.

1. General observations

The ABA welcomes the legislative amendments including:

- Reduced disclosure requirements for financial products, making it simpler for consumers and less onerous for financial service providers;
- Better recognition of 'sophisticated investors', meaning that some investors who find current disclosures unnecessary to assist them in making an informed decision, will no longer have to receive lengthy disclosure documents when they get financial advice; and
- Streamlined reporting obligations for financial service providers and reporting entities, for example, the ability to distribute company annual reports via the Internet or other electronic means.

2. Specific comments

2.1 Financial services regulation

The ABA supports the decision not to implement the 'sales recommendation model' (proposal 1.1) in the Bill. It is our view that a better approach would involve:

- Amending the definition of personal advice (limiting the definition to circumstances where a recommendation is made and acted on); and
- Removing simple products (such as basic deposit products, non-cash payment facilities, general insurance products, consumer credit insurance products and cash management trusts) from the advice regime.

This approach would also address a number of industry and consumer concerns that are driving considerations about amendments, such as SOA exemption (proposal 1.2) and SOA threshold (proposal 1.3). The ABA is pleased to continue to work with the Government and Treasury on identifying a practical solution.

2.1.1 Scope of financial services advice — SOA exemption — no product recommendation and no remuneration

ABA response: The ABA provided comments on the initial FSR refinement regulations, which provided some relief for SOAs. The proposed legislative amendment attempts to address problems with regard to advice provided in initial fact-finding interviews and update reviews providing asset allocation or strategic advice. Furthermore, it seeks to remove a frustration for retail customers who must be given a SOA, even if a product is not recommended and the adviser is not remunerated directly in relation to the provision of advice. The ABA supports the amendment in principle, in the interests of customer satisfaction, reduced paperwork and reduced cost of financial advice. However, the amendment contains some inflexibilities that in practice will mean the amendment could be of little value.

This legislative amendment is designed to encourage the provision of financial advice for small investors and to enable financial advisers to conduct an initial fact finding, consultation or update review for clients at a lower cost.

It is proposed that an exemption from the requirement to produce a SOA would apply in circumstances where:

- the personal advice does not contain any recommendations relating to the acquisition or disposal of any specific financial product or the financial products of a specific product issuer; or the personal advise does not recommend a modification to an investment strategy or contribution level in relation to a financial product held by a client; and
- the adviser does not receive any remuneration or other benefit in relation to the advice.

The client must be given the information that would otherwise have been given in a SOA in the same communication in which the client receives the advice and a record of the advice must be retained by the adviser.

It is the ABA's view that if the definition of personal advice were narrowed, then the changes being progressed with this amendment would not be required. Nevertheless, the requirement to prepare a SOA as part of the advice process is often seen as too onerous and costly and has resulted in the widespread adoption of the 'no advice' model.

Therefore, we acknowledge and applaud the attempt to address this problem with this amendment. However, the current amendment presents some practical problems and uncertainties that would likely mean that the relief would be of little value to advisers in most client situations.

Some ABA comments:

- *Products of a specific issuer*: The amendment restricts a representative from providing a recommendation relating to "the financial products of a specific product issuer". Para 7(a)(i) would mean a representative would be unable to benefit from the relief where a representative recommends a class of financial products of the same licensee. It is our view that this is impractical.

- *Initial meeting*: The amendment appears to intend to capture only the initial meeting of an adviser with a client, when there are other scenarios within the advice process which would benefit from the reduced compliance obligations, such as a rebalance of a client's investment strategy or top up investment. Para 7(a)(ii) would restrict advice relating to a product already held by a client. It is our view that this would not streamline the compliance process for these types of situations.

- *Remuneration*: The amendment restricts an adviser from receiving remuneration or a benefit directly, or in relation to, the advice. Advisers may operate under a number of remuneration structures including on a fee for service basis; under a commission structure linked to a licensed dealer; through salary or wages; or via a plan fee paid directly from a fund/product. Advisers may use more than one of these remuneration structures, depending on their business model and client base. Para 7(b) means the relief would be unavailable if the adviser gets paid. It is our view that this is impractical. It is also unclear how the amendment would impact on an adviser that receives a salary not related to the advice. It is our view that a more definite description of "remuneration" should be provided.

- *Disclosure*: The amendment requires an adviser to give the client details of remuneration and association with product issuers at the same time as giving the advice. However, the exemption only applies when no remuneration is received. It is our view that this requirement in para 8 is inappropriate and unnecessary. The intent and operation of para 8 is unclear in how the information is to be provided to the client. It seems that the amendment will create an alternative disclosure and form the basis of a 'strategic advice statement', which would be provided orally to the client in the relevant circumstances. We suggest that para 8 be deleted. Furthermore, the amendment refers to the adviser keeping a record of the advice. Currently the law enables a ROA to be retained and provided to a client where an eligible advice document, such as a SOA, has already been provided to the client. We suggest that to avoid confusion for advisers and their clients, that para 9 should be amended.

The ABA considers that financial service providers should have the option for an adviser to give the consumer a SOA in circumstances which would otherwise come within the exemption. There may be some instances where it is suitable for both the client and the adviser to provide a SOA. We note that the legislative amendment does no appear to impose a limitation in this respect.

2.1.2 Scope of financial services advice — SOA threshold

ABA response: The ABA recognises that the cost of advice is of concern. The ABA supports proportionality (or scalability) of advice as a means of reducing costs for industry and consumers. We support this amendment in principle; however, it will need to be implemented in a manner that does not compromise the consumer protection intent of the law and does not create unnecessary complexities for industry.

This legislative amendment is designed to increase accessibility, availability and affordability of financial advice for small investors. The time and cost involved in producing a SOA has in some instances restricted access to financial advice for small investors. Alternatively, some financial service providers have introduced a 'no advice' model, limiting the availability of advice for those seeking to invest small amounts. It is important that the law does not unintentionally restrict access to advice for small investors.

While this amendment will not reduce all the costs associated with providing financial advice, it will go a significant way to reducing the costs of providing advice to small investors, such as those incurred with producing lengthy SOAs, and therefore provide consumers with access to appropriate and affordable advice based on their means and without the need to provide consumers with volumes of paperwork.

However, the current amendment presents some practical problems and uncertainties that would likely mean that the change will be of little value to financial service providers, advisers and their customers.

Some ABA comments:

- *Threshold amount*: The threshold amount will be prescribed by Regulations and will be worked out in relation to particular kinds of financial products. It is anticipated that the threshold amount will be $15,000, although there could be different thresholds for different classes of financial products. It is unclear the basis for the determination of the threshold and how the threshold will be worked out for particular financial products or classes of financial products. The threshold amount should be simple and clear for industry and consumers. It should also be set at an amount that would enable industry and consumers to receive the benefits of the relief. It may be that different thresholds should be applied, for example, $15,000 for a purchase of securities or a term deposit; whereas $25,000 for investment in a managed fund, where typically minimum investments exceed $15,000.

- *Total value of investments*: The amendment refers to 'total acquisition value' and 'total disposal value' where the value pertains to the value of each acquisition or disposal. Para 2, in conjunction with para 1, seems to restrict all (subsequent) investments made in relation to the advice. It is our view that this unduly limits the relief so that in practice the relief would only apply to one-off small sales or investments. We note that the amendment provides relief for realignment of investment portfolios where the exemption applies to the net acquisition/disposal; however, the limit on subsequent investment and future contributions means that the amendment is impractical.

- *Products excluded*: The amendment restricts the relief to certain financial products or classes of financial products. Para 1(b) and 1(c) mean that relief is not available for advice in relation to derivatives, superannuation or RSAs (except where the client already has an interest), general insurance products and life risk insurance products (except within superannuation). These exclusions are ambiguous and the basis is unclear. General insurance products are afforded SOA relief pursuant to Regulation 7.7.10. Only life risk insurance products inside superannuation can take advantage of the relief, whereas superannuation is excluded. It is our view that excluding general insurance products is not scalable and proportionate to the risk profile of the product and at odds with previous FSR refinements. It is also our view that the exclusion should not apply to life risk insurance products. We note that excluding initial investments in superannuation from the relief means that many people will be unable to access low cost retirement planning advice. This is particularly important given the recent changes to superannuation and taxation law. Exclusions would create additional complexities for representatives and consumers and sensibly these exclusions should be removed.

- *Record of Advice*: The amendment requires the adviser to retain a ROA and provide it to the client at the point of sale (or as soon as practicable after) and give the client information that would otherwise have been given in a SOA. It is our view that the adviser should provide a 'modified ROA' for 'small investment advice'. A modified ROA would provide details of the fees and features of the product and would be used in a similar manner to the existing FSG, and ideally in conjunction with a PDS. This form of disclosure should provide a balance between meeting consumers' interests and achieving appropriate costs for smaller scale advice. It would be sensible for industry representatives to work with ASIC to develop the required information to be included in a 'modified ROA'.

The ABA notes that where advice is provided on products relating to amounts less than the threshold, a SOA is not required, even if the personal advice contains a recommendation relating to a specific product or the products of a specific issuer and the adviser receives remuneration related or unrelated to the advice. While the amendment is not explicit in this regard, it would appear that relief would be available for advice relating to the acquisition or disposal of interests in certain products under certain circumstances.

Currently the amendment would suggest:

Scenario 1: Client has $30,000 invested in a superannuation fund and wants to invest another $12,000. The adviser provides personal advice to this effect, but would not be required to provide an SOA, but an ROA.

Scenario 2: Client meets with an adviser to discuss investing $12,000. The adviser recommends a superannuation product. The adviser would be required to meet the personal advice obligations, including providing the client with an SOA.

However, it is unclear how the legislative amendments may interact:

Scenario 3: Client meets with an adviser to discuss investing $12,000. The adviser recommends a 3 year term deposit product by a specific product issuer and the adviser receives a salary. (While this would possibly fall outside the SOA exemption relief (above) it is within the SOA threshold relief, and therefore a SOA would not be required, but an ROA).

2.1.3 Sophisticated investors

ABA response: This ABA supports this amendment in principle, but not in its current form. Careful consideration needs to be given to how this may work in practice so that the amendment does not compromise the consumer protection intent of the law or create unnecessary complexities for industry. In the absence of amendments to address concerns with the 'small business test', the ABA supports further refinement so that the amendment can be applied in cases of small businesses, such as rural producers and importers/exporters.

This legislative amendment is designed to allow financial service providers to treat sophisticated investors that do not satisfy the existing threshold tests for wholesale investors as contained in the law at present as sophisticated investors, provided that the financial service provider is satisfied as to their level of knowledge. We are aware that some investors currently treated as retail investors find the retail disclosures unnecessary as the activities and products are well understood, and therefore for financial service providers such retail disclosures are unnecessary costs.

The ABA acknowledges the previous FSR refinements as going some way to addressing the anomalies with the 'retail/wholesale distinction'; however, there needs to be further refinement and simplification. We note that a number of suggestions have been proposed in the past. Previously the ABA suggested a number of options for addressing concerns with the 'retail/wholesale distinction', including applying the provisions of section 708(10) of the Corporations Act, coupled with amending the small business test.

Many businesses with large turnovers and/or assets are treated as 'small businesses' because they fail the employee number threshold as currently contained in the law or highly trained individuals fail the net worth test. It is our view that modifying the small business test would be a preferred way of addressing concerns with inconsistent definition and application across financial products for small businesses. However, in the absence of amending the 'small business test', we believe that the sophisticated investor test should apply to individual and business investors, i.e. enabling businesses that satisfy the criteria to be treated as 'sophisticated businesses'.

The ABA considers that the 'sophisticated investor' designation for investors, individual or small business, which may currently be caught by the FSR retail client provisions, would hold benefits for both industry and these retail investors. At present the various 'retail/wholesale distinction' tests in the law are convoluted for individual customers and small business customers. These arbitrary distinctions may be adversely impacting the efficiency of financial service provider-client relationship as well as compromising the effectiveness of the consumer protections within the law.

Applying a mechanism similar to that which exists in Chapter 6D to Chapter 7 of the Corporations Act enables a financial service provider to be satisfied that an investor is adequately equipped to be determined a wholesale investor. A financial service provider must: (1) be satisfied that their client has previous experience that allows them to knowledgably assess the trade, transaction or investment; and (2) provide their client with a written statement of their reasons for being satisfied. The client must provide the financial service provider with a written acknowledgement that they have been provided with disclosure in relation to the trade, transaction or investment.

However, while the ABA considers that the section 708(10) criteria provides a useful basis, it will be necessary to refine the criteria to apply to all financial products contained in Chapter 7. The amendment currently does not adequately reflect the manner in which clients conduct their transactions with 'financial products'.

Some ABA comments:

- *Investors*: The amendment applies to 'investors'. It is unclear whether this excludes those managing a financial risk. We suggest that the amendment refer to 'sophisticated clients'.

- *Documentation excluded*: The amendment excludes financial service providers from giving their clients a FSG, PDS, SOA or ROA or other document that can be provided to a retail client. It seems nonsensical that where a financial service provider gives their client information about a product or service that this would exclude them from taking advantage of the relief. It is our view that where the client has acknowledged that they will be treated as 'sophisticated', that there should be no reason why they should not be able to get product and service information at the discretion of the financial service provider. We suggest that the amendment be changed as follows:

  > "the client signs a written acknowledgment before, or at the time when, the product or service is provided that:
  >
  > (i) the licensee does not have an obligation to give the client a Product Disclosure Statement; and
  >
  > (ii) the licensee does not have an obligation to give the client any other document that would be required to be given to the client under this Chapter if the product or service were provided to the client as a retail client; and
  >
  > (iii) the licensee does not have any other obligation to the client under this Chapter that the licensee would have if the product or service were provided to the client as a retail client."

- *Transaction*: Financial service providers and their clients should not be required to provide written statements for each trade, transaction or investment (i.e. on a one-off basis). This will create administrative problems as well as potentially disadvantage clients; for example, foreign exchange markets move very quickly and time is a critical factor. It is our view that the written statement should be defined to cover a class or sub-class of financial products (i.e. on a product basis) and that the retail investor shall be treated as a wholesale investor for the ongoing provision of financial services for that class or sub-class of financial product(s). This would mean that an investor could be treated as wholesale for some products and retail for others commensurate with their knowledge and/or experience. The application to a class or sub-class of financial products should be explicit in the amendment. It would also be useful to include an 'opt-out' mechanism for retail clients to choose not to be treated as a retail client for the purpose of advice in relation to a range of products.

- *Reasonable grounds*: The amendment requires a financial service provider to be satisfied on 'reasonable grounds' that the client has previous experience. It is our view that financial service providers should not have the onus of having to establish the investor's capabilities. As the client must provide a written acknowledgement, this alleviates some uncertainty as to establishing knowledge and/or experience as it provides time for the client to give consideration to the implications of their written acknowledgement. The test would apply on the basis of the client's competence and experience with a particular financial product, their comprehension of financial product and market concepts, and any formal qualifications or training undertaken by the client (although formal training would not be the only determining factor). It

is important that both the client and the licensee are satisfied on reasonable grounds that the client can be treated as 'sophisticated'. In the case of a dispute, we would envisage that the client's written acknowledgement would offer some protection for financial services providers.

- *'Sophisticated businesses'*: The amendment does not apply to representatives of businesses that are authorised to conduct trades, transactions or investments on behalf of their businesses. Para 761GA(c) means that the relief can not be applied to 'sophisticated business'. It is our view that where a representative of a business can satisfy the criteria to conduct transactions, trades or investments on behalf of the business as a wholesale investor, relief should apply. In the absence of relief as a 'sophisticated investor' or amendment to the 'small business test', unnecessary compliance costs will be carried by industry and business.

2.1.4 Cross endorsement of authorised representatives

The ABA supports this amendment to section 917C(3)(b), which enables financial products to be prescribed by Regulations in this respect. The amendment is intended to apply to general insurance; however, we believe that it should be expanded to include other financial products, such as managed investment schemes, life insurance and superannuation.

2.1.5 Product activity and data collection

ABA response: The ABA supports this amendment in principle, as it intends to reduce the compliance burden on product issuers associated with in-use notices. However, it will be important to ensure that reporting efficiencies and reduced compliance costs afforded by the implementation of the standardised online reporting system are not compromised by the specific details of the notice.

This legislative amendment is designed to implement an efficient mechanism for providing notices to ASIC so the regulator has accurate ongoing information about which financial products are being promoted to the market and available to retail clients.

The ABA welcomes this amendment; however, the practical implications of some aspects of the amendment are unclear. Furthermore, while we recognise that the reporting requirement is less onerous than initial proposed, this increased reporting obligation and new notification process imposes an additional regulatory burden on product issuers.

Some ABA comments:

- *Fees and charges*: The amendment will require product issuers to provide a report to ASIC when there is a change to fees and charges. The legislation and explanatory memorandum contain differing requirements; referring to PDS, enhanced disclosure fee table and statement. It is our view that the intention of the amendment was to capture superannuation and managed investment fees and charges, rather than all products and PDSs. If the latter were imposed this would result in a significant increase in compliance costs for product issuers and reporting to ASIC. Para 2(b) should be amended to refer to "fees and charges as set out in the enhanced disclosure fee table".

- *Materiality test*: The current obligation to notify ASIC of new PDSs and where there has been a material change is outlined in ASIC QFS 136: *What changes can be made to a PDS or a SPDS without triggering the requirement to lodge a new in-use notice under s1015D?* It would be sensible for industry representatives to work with ASIC to ensure that any guidance about the new reporting procedures reflects a sensible approach and contains a materiality test for reporting.

- *Notices*: The amendment requires a product issuer to notify ASIC within 5 business days that a PDS is in-use, a change is made to fees and charges and a PDS ceases to be available. It is unclear how the timeframe for reporting will be implemented. Some products, for example, life risk insurance products require finalising of underwriting of applications received before the PDS can be withdrawn. This may take some time after the decision to withdraw has taken place. It is also unclear how the amendment relates to supplementary PDSs. It would be sensible for industry representatives to work with ASIC to ensure that any guidance about the new reporting procedures reflects a sensible and practical approach.

The ABA notes that this amendment will commence on 1 July 2008. It is important for industry and ASIC to have adequate time to make changes to systems and procedures to reflect the new reporting obligations. We would envisage that ASIC will consult industry about the development of its standardised online reporting system to ensure that reporting can be streamlined as far as possible and that no additional obligations are created.

2.2 Company reporting obligations

2.2.1 Executive remuneration

ABA response: The ABA supports this amendment in principle, as it removes unnecessary duplication across disclosure requirements for companies and improves transparency of reporting for shareholders. However, it will be necessary to clarify certain aspects of the proposal to ensure that it does not introduce additional regulatory burden or unnecessary compliance costs.

This legislative amendment is designed to reduce the duplication of remuneration disclosure requirements for directors and executives and refine the framework to ensure shareholders continue to be provided with relevant and accessible information relating to remuneration. (Subsequent to the CLERP 9 reforms, there are remuneration disclosure requirements contained in the Corporations Act, ASX Listing Rules and Accounting Standards.)

It is the ABA's view that duplication should be removed so that there is only one set of rules for director and executive remuneration disclosure. Therefore, we support the amendment to harmonise and remove duplication in remuneration disclosure requirements[1]. However, there are a number of aspects to the amendment that are problematic.

[1] Previously the ABA has suggested that the Corporations Act requirements should be repealed, and AASB 124 *Related Party Disclosures* expanded to include all current additional Corporations Act requirements. However, this amendment in effect achieves this outcome by removing the disclosure requirements for directors and executives from the Accounting Standards and Corporations Regulations, except where it is necessary for listed companies to be able to report in compliance with IFRS.

Some ABA comments:

- *Remuneration report*: The amendment requires a remuneration report to be audited and where the director's report contains a remuneration report, the auditor must provide an opinion to members as to whether the remuneration report complies with section 300A of the Corporations Act. It is our view that the auditor should only be required to audit the accounting information in the remuneration report, not the narrative text (e.g. when the disclosing entity discusses its policy on executive remuneration). If the entire remuneration report is required to be audited, this will increase the compliance cost and burden on companies required to have additional auditing beyond that portion which is already contained in the financial statements (and thus audited) without any additional benefit.

- *Subsidiaries*: The amendment does not provide a specific exemption from the requirement to provide a remuneration report for a disclosing entity, which is a wholly owned subsidiary of another disclosing entity. It is our view that the requirement for disclosing entities to produce a remuneration report for a wholly owned subsidiary is unnecessarily burdensome.

2.2.2 Electronic distribution of annual reports

The ABA welcomes this amendment. It is pleasing that it is intended to take effect for the 2006/07 year. However, it is not apparent the transitional arrangements for companies and members. For example, it is unclear what happens to those investors that have already opted out of receiving fund reports under the current regime. In addition, application forms attached to existing disclosure documents usually contain an 'opt-out' provision, which means that documents will need to be updated. We believe that transitional arrangements should be clarified.

3. Concluding remarks

The ABA is pleased that the Government continues to refine the legal and regulatory requirements that apply to financial service providers. These reforms will reduce red tape for banks and their customers without compromising important consumer protections.

The ABA continues to work with Government and consumer representatives on refinements that better address the balance between costs for industry and protections for consumers relating to the scope of the advice regime. The banking sector supports a solution that is practical and addresses industry and consumer concerns with how the advice regime captures simple financial products.

The ABA is, and will, be working with the Government, Treasury, APRA and ASIC on a number of other important changes which, amongst other things, form part of the Government's response to the Regulation Taskforce, including:

- Draft Corporations Amendment Regulations 2007, containing changes relating to streamlining disclosures, such as incorporating information by reference into disclosure documents;

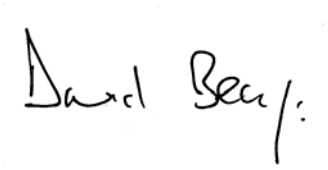
- Exposure draft Financial Sector Legislation Amendment (Simplifying Regulation & Review) Bill 2007, containing changes relating to breach reporting and use of ABN; and

- Review of ASIC policy statements, including PS 146: Licensing: Training for advisers; and PS 164: Licensing: Organisational Capacities.

Given the extent of the legislative amendments and other refinements to financial services and corporations regulations, it would be preferred that changes resulting from the various Bills be implemented in conjunction. For example, the use of the ABN is being explored in both the "Corporations and Financial Services" and "Prudential" areas.

The ABA would be happy to discuss any of the issues raised in our submission with you further. Please contact me or Diane Tate, Director, Corporate & Consumer Policy on (02) 8298 0410: diane.tate@bankers.asn.au.

Yours sincerely



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