The Senate

Economics Legislation Committee

Financial Services Reform Amendment Bill 2003 and certain associated regulations

December 2003

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CHAPTER 1

INTRODUCTION

Background

1.1 The Financial Services Reform Amendment Bill 2003 was introduced into the House of Representatives on 26 June 2003 by the Hon. Peter Slipper MP, Parliamentary Secretary to the Minister for Finance and Public Administration.

1.2 The Senate Economics Legislation Committee reported on the provisions of the Financial Services Reform Amendment Bill 2003 on 19 August 2003. Subsequently, the government moved a number of amendments to the bill. The bill was passed in the House of Representatives on 5 November 2003.

Reference of the bill and regulations (Batches 5 and 6)

1.3 On 26 November 2003, the Senate adopted Selection of Bills Committee Report No. 15 of 2003 and referred the bill to the Committee for report by 3 December 2003.[1] At the same time, the Senate referred to the Committee associated regulations and draft regulations for inquiry and report, as follows:

- Corporations Amendment Regulations 2003 (No.8) No.282 (Batch 5); and
- Draft Corporations Amendment Regulations 2003 (No.) (Batch 6).

Purpose of the bill and regulations

1.4 The *Financial Services Reform Act 2001* (FSR Act) commenced on 11 March 2002. It amended the *Corporations Act 2001* (the Act) and related legislation, introducing a new regulatory framework for the licensing, conduct and disclosure of providers of financial services, and a licensing regime for financial markets and clearing and settlement facilities.

1.5 The amendments to the Act made by the FSR Act are subject to a two year transition period, and will come into full effect on 11 March 2004. During the transition period, the Government has consulted with industry and consumer representatives to ensure a smooth implementation of the new arrangements. Through this consultation process a number of issues have been identified which require clarification or amendment to enable members of the industry to move into the new arrangements. The bill will clarify and amend various aspects of Chapter 7 and related provisions of the Act. It will also make minor amendments to the *Income Tax Assessment Act 1997* and the *Retirement Savings Accounts Act 1997*.

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1 *Journals of the Senate*, 27 November 2003, p. 2747.

Regulations – batch 5

1.6 Amongst other things, the FSR Act requires the disclosure of relevant information in the form of a product disclosure statement (PDS), before a person purchases a financial product. In addition financial investment product holders are to receive ongoing information about their product in the form of periodic statements. Both kinds of statement are intended to promote informed investment decisions and understanding of financial products.[2]

1.7 The regulations in batch 5 will facilitate transition to the new licensing, conduct and disclosure arrangements and promote certainty, clarifying, where necessary, various provisions under the FSR Act. The regulations make amendments that:

- close a potential loophole which may have allowed for the circumvention of point-of-sale disclosure obligations;
- remove impractical point-of-sale disclosure obligations related to declined offers of financial products and situations where clients are uncontactable;
- address practical concerns regarding the disclosure of amounts paid within periodic statements for investment financial products;
- ensure that a prospective member of a self-managed superannuation fund receives information necessary to make an informed investment decision through the timely provision of a PDS;
- aid consumer comprehension by requiring disclosure in dollar terms in the first instance and where practicable in a range of disclosure documents; and
- enhance the disclosure of superannuation benefits within periodic statements. [3]

Draft regulations – batch 6

1.8 The regulations in batch 6 comprise a collection of non-related regulations that traverse matters ranging from defining a medical indemnity insurance product to issues of disclosure. Some of the proposed amendments are technical in nature while others insert new paragraphs exempting certain conduct and professions under specific circumstances.

1.9 Significant regulations in this batch include:

- Proposed regulation 7.6.01C which specifies the range of FSR-related documents which require the Australian Financial Services Licence (AFSL) number to be included on them. The regulation would not require the AFSL

2 Explanatory Statement, Corporations Amendment Regulations 2003 (No. 8) 2003 No. 282, (Batch 5), p. 1.

3 Explanatory Statement, Corporations Amendment Regulations 2003 (No. 8) 2003 No. 282, (Batch 5), p. 1.

number to be included on periodic statements until the beginning of the 2004-05 financial year in order to allow existing stocks of stationary to be depleted; and[4]

- Proposed new regulation 7.6.08 modifies the operation of Section 923A of the Act. Section 923A restricts a person's ability to hold themselves out as being 'independent' in certain circumstances. Practical concerns have been raised in relation to the operation of these provisions, and the proposed regulation deals with those concerns.[5]

Submissions

1.10 The Committee contacted a number of individuals and organisations, including the Treasury and the Australian Securities and Investments Commission, alerting them to the inquiry and inviting them to make a submission. A list of the parties from whom submissions were received appears at Appendix 1.

1.11 The Committee received seven submissions. All submissions supported various aspects of the Bill. Some submissions suggested further amendments to the Act

Hearing and evidence

1.12 The Committee held one public hearing on this inquiry in Parliament House, Canberra on 1 December 2003. Witnesses who appeared before the Committee at that hearing are listed in Appendix 2.

1.13 Copies of the Hansard transcript are tabled for the information of the Senate. They are also available through the Internet at http://aph.gov.au/hansard.

Acknowledgment

1.14 The Committee is grateful to, and wishes to thank, all those who assisted with its inquiry.

4 Corporations Amendment Regulations Commentaries (Batch 6), Schedule 2 Item [2].

5 Corporations Amendment Regulations Commentaries (Batch 6), Schedule 2 Item [5].

CHAPTER 2

THE BILL AND REGULATIONS

2.1 In this chapter, the Committee outlines the amendments to the bill and the regulations which attracted most comment during the inquiry.

Financial Services Reform Amendment Bill 2003

Amendment to section 761A – definition of 'basic deposit product'

2.2 Schedule 2, Items 6 and 7 amend the definition of 'basic deposit product' in section 761A of the *Corporations Act 2001* (the Act). The amendment expands the definition to include deposit products with a term of five years or less. Similarly, term deposits with a maturity of five years or less will not need to be 'at call' in order to be included in the definition of basic deposit product.[1]

Amendment to section 946B—'further market-related advice'

2.3 Section 946B refers to 'execution-related telephone advice' (ERTA) which is advice given by telephone that:

- concerns financial products able to be traded on a financial market;
- is a core part of the transfer of or the order for the financial products; and
- contains no other financial product advice.

2.4 The section allows an exemption (the stockbroker exemption) from the requirement to provide clients with a Statement of Advice (SoA) provided the following conditions are met:

- before the ERTA is given, the client must agree to an SoA not being provided;
- the 'providing entity' must still give the client details of any commission, remuneration or other benefits and of any relationships of influence that might affect the advice given; and
- the providing entity must keep a record of the advice.[2]

2.5 The Explanatory Memorandum for the Financial Services Reform Bill 2001 that inserted this provision says:

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1 Financial Services Reform Amendment Bill 2003, Revised Explanatory Memorandum, Parliament of the Commonwealth of Australia, Senate, p. 9.

2 Corporations Regulation 7.7.90 requires the ERTA record to be kept for at least 90 days after the day on which the ERTA is given.

> This exception is based on the existing Corporations Law regime exception for execution-related telephone advice provided in relation to securities. This exception has been extended to cover all financial products that are able to be traded on a licensed financial market.
>
> …
>
> The objective of these provisions is to provide the client with the consumer protections afforded by the SOA and related disclosure requirements, while at the same time ensuring that the giving of telephone-executed advice and the ability of the client to act quickly on that advice is not unduly hindered.[3]

2.6 The section provides a second exemption where advice concerns a basic deposit product or a facility for making non-cash payments if related to a basic deposit product. Details of commission and remuneration, and relationships of influence (as for ERTA) must also be disclosed.

2.7 Amendments to section 946B clarify the stockbroker exemption and recognise that not all telephone advices will require 'execution' of some sort—hence the use of the term, 'further market-related advice' (FMRA), in substitution for 'execution-related telephone advice'.

2.8 More specifically, the amendments providing for the exemption apply to a participant (or the participant's authorised representative) if the following conditions have been satisfied:

- an SoA has previously been given to the client (a previous SoA);
- the client's circumstances and the basis on which the FMRA are given are not significantly different from those covered in the previous SoA;
- the adviser has a reasonable belief that the client needs the FMRA promptly or it is in the client's interests to provide FMRA promptly—the supplementary Explanatory Memorandum says the requirement 'that advice is given in the context of a "live" financial market' is 'a critical element of the concessions provided';[4]
- the FMRA does not contain financial product advice of a kind not covered in the previous SoA (or is otherwise advice relating to a cash management facility); and
- details of commission and remuneration, and relationships of influence (as required in the current section) are provided 'in the same communication as is used to provide the further market-related advice to the client.'

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3 Financial Services Reform Bill 2001, Explanatory Memorandum, Parliament of the Commonwealth of Australia, House of Representatives, p. 115.

4 Financial Services Reform Amendment Bill 2003, Supplementary Explanatory Memorandum, Parliament of the Commonwealth of Australia, House of Representatives, p. 7.

2.9 Whereas the current provision refers to advice given in relation to 'financial products that are able to be traded on a licensed market', the proposed amendment refers to 'securities, managed investment products or derivatives that are able to be traded on a licensed market'.[5] The Supplementary Explanatory Memorandum says with regard to this amendment that:

> An important element of the amended section 946B is the range of financial products to which it relates. Rather than referring to *financial products* able to be traded on a licensed market as the current section 946B does, the new provision is expressed to apply in respect of *securities, managed investment products and derivatives* (all defined in section 761A) able to be traded on a licensed market.[6]

2.10 The proposed amendments follow objections made by the Australian Stock Exchange Limited and the stockbroking industry that current requirements would do little to limit the paperwork generated when providing advice to clients. According to media reports circulating in June and July this year, opposition among financial industry participants to SoA requirements in particular was becoming increasingly vociferous.[7] Exemptions currently provided in section 946B were not discussed. However, it appears from a report in the *Australian Financial Review* on 3 July 2003 that the current requirements in section 946B for compulsory record-keeping and the issuing of summaries to clients in lieu of SoAs may have been the main sticking points—at least as far as stockbrokers were concerned.[8]

2.11 During discussion in the House of the proposed amendments to the Bill, Mr Alan Griffin MP raised concerns that consumers could lose valuable protections provided by SoA requirements. In particular, he said that:

> Labor's concern [with the amendment] is that it assumes that the broker will be making regular inquiries about the client's personal circumstances and so will know if they do in fact change…It may be the case that an additional requirement is necessary—for example, a requirement that the broker go back to the client at least annually to check whether their circumstances have changed. Labor will consider moving an amendment to this effect in the Senate. The interesting point about the provision is that even though the broker is no longer required to provide an SOA they are still required to

5 Proposed subparagraph 946B(1)(b)(ii).

6 Financial Services Reform Amendment Bill 2003, Supplementary Explanatory Memorandum, Parliament of the Commonwealth of Australia, House of Representatives, p. 8. The cited statement does not explain why this amendment was considered necessary.

7 See, for example, 'ASX warns against excessive broker disclosure', *Sydney Morning Herald*, 30 June 2003, p. 27; 'Canberra caves in on investor rules', *Australian Financial Review*, 3 July 2003, p. 1; 'Brokers still facing a mountain of paperwork', *Sydney Morning Herald*, 4 July 2003, p. 21; 'More dealers call for exemptions', *Sydney Morning Herald*, 7 July 2003, p. 29.

8 See, for example, 'Advice rules anger brokers', *Australian Financial Review*, 3 July 2003.

> make other disclosures in relation to issues like remuneration and conflicts of interest.[9]

2.12 In answer to criticisms about the possible dilution of consumer protections, Mr Ross Cameron MP, Parliamentary Secretary to the Treasurer, said that:

> The measures to ensure that the current protections remain and the exemptions are not abused include that the provision applies only to participants on licensed markets and their authorised representatives in relation to advice on financial products traded on such markets; the advice provider must have a reasonable belief that the advice is required promptly; and the prerequisite remains that any new client has already been given a statement of advice at the beginning of the relationship with the advice provider.[10]

Corporations Amendment Regulations 2003 (No. 8) (Batch 5)

Proposed amendments to regulations 7.7.11, 7.7.12 and new regulations 7.7.13 and 7.9.15A

2.13 Amendments have been made to regulations 7.7.11 and 7.7.12[11] to require the disclosure of 'remuneration, commission and benefits payable' in the Statement of Advice:

- to be in dollar amounts;[12]
- if it is not 'reasonably practicable' to state dollar amounts, to set out the amount as a percentage; or
- if it is not 'reasonably practicable' to state an amount or percentage, to set out the calculation method used giving worked dollar examples.

2.14 New regulation 7.7.13 also relates to the SoA and requires disclosure of dollar amounts, percentages or worked dollar examples in relation to any recommendation given to a client that the client dispose of or reduce an interest in a financial product and instead increase an existing interest in or acquire another financial product.

2.15 New regulation 7.9.15A requires disclosure of dollar amounts, percentages or worked dollar examples in Product Disclosure Statements (PDS) in relation to:

- any significant benefits to which a holder of the product may become entitled and the circumstances in which such an entitlement would arise; and

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9 *House Hansard*, 4 November 2003, p. 21,987.

10 *House Hansard*, 5 November 2003, p. 22,110.

11 Regulations 7.7.11 and 7.7.12 apply to the Statements of Advice provided by a financial services licensee and an authorised representative respectively. The amendments replace subparagraphs 7.7.11(2)(a)(i) and (ii) and 7.7.12(2)(a)(i) and (ii).

12 Subparagraphs 7.7.11(2)(a)(i) and 7.7.12(2)(a)(i).

- commission or any similar payments that will affect the return generated to a holder of the product.

2.16 The Explanatory Statement for these regulations say that they achieve 'consistency in terminology' in the Corporations Regulations and are 'not intended to reduce the effect of any existing requirements to disclose items in dollar terms'. The Explanatory Statement says further that:

> The regulations do not impede financial services and product providers from disclosing items in terms of one or more forms, if relevant, subject to the 'clear, concise and effective' requirement and prohibitions on false, misleading or deceptive statements.[13]

2.17 The amendments in these regulations apply only to those disclosure documents prepared on or after 1 July 2004 to give affected parties sufficient time to adjust to the new requirements.

2.18 The requirements closely mirror those already specified in ASIC Policy Statement 175: *Licensing: financial product advisers: Conduct and disclosure*.

Proposed amendments to regulations 7.9.19 and 7.9.20 and new regulation 7.9.19A

2.19 Under section 1017D, an issuer of specified financial products[14] must provide the holder of the financial product with a periodic statement every year with details of the product's performance.

2.20 Amended regulations 7.9.19 and 7.9.20 and new regulation 7.9.19A apply only to periodic statements given to a member of a superannuation fund (other than a self managed superannuation fund) or an RSA holder. The Explanatory Statement for these regulations states that they 'will enhance the existing requirement to disclose information about the amount of a 'withdrawal benefit' or other significant benefits.'[15]

2.21 In particular, periodic statements will have to clarify the nature of withdrawal or significant benefits and clarify that amounts provided are estimates only and could vary from actual benefits.

2.22 As with disclosure requirements for the Statement of Advice and Product Disclosure Statement, amounts disclosed must be dollars or percentages (with worked

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13 Explanatory Statement, Corporations Amendment Regulations 2003 (No. 8) 2003 No. 282, p. 8 of 15 at http://scaleplus.law.gov.au/html/ess/0/2003/0/20031113282.htm.

14 The financial products cited in the provision are: managed investments, superannuation, an RSA product, investment life insurance or a deposit product.

15 Explanatory Statement, Corporations Amendment Regulations 2003 (No. 8) 2003 No. 282, p. 8 of 15 at http://scaleplus.law.gov.au/html/ess/0/2003/0/20031113282.htm. The Statement defines 'withdrawal benefit' as 'the amount a fund would provide to a member for the voluntary cessation of their interest in the superannuation fund at the end of a period.'

dollar examples). If an amount or percentage cannot be supplied, the statement must indicate that fees, charges or expenses are applicable and, if not already given, details of how a product holder can access information about the amount of deductions.[16]

2.23 Similar amendments have been made to regulation 7.9.20(1) regarding the disclosure of details of 'other significant benefits, including disability benefits' and also to regulation 7.9.75 which deals with the disclosure of transaction costs in periodic statements.

2.24 To allow sufficient time for affected parties to make the transition to the new arrangements, they will only apply to documents for reporting periods commencing on or after 1 July 2004.

Proposed Corporations Amendment Regulations 2003 (Batch 6)

Regulation 7.6.08—modifications to section 923A of the Act

2.25 Section 926A has been inserted as an amendment to the Financial Services Reform Amendment Bill 2003 and extends exemption and modification powers to ASIC in respect of Part 7.6 of the Act (except for Divisions 4 and 8) and regulations made under that Part. Section 926B, also inserted as an amendment to the Bill, allows for regulations that:

- exempt a person (or class or persons) or a financial product (or class of financial product) from all or some of the provisions of Part 7.6; and
- provide for the application of Part 7.6 as if specified provisions were omitted, modified or varied.

2.26 Part 7.6 of the Act contains provisions regarding the licensing of financial services providers. The proposed exemption and modification powers will not apply to the provisions in Division 4 which set out the requirements to be satisfied before a licence can be granted; any conditions that may be attached to licences; and the circumstances under which licences can be varied, suspended or cancelled. The exemption will also not apply to Division 8 provisions dealing with banning orders and court disqualifications.

2.27 The Revised Explanatory Memorandum states that:

> [Sections 926A and 926B] will provide flexibility for either ASIC or the regulations to grant relief or concessions through exemption from, or modification to, the provisions in Part 7.6. New section 926A is similar to the exemption and modification powers provided to ASIC under other Parts of Chapter 7…with the difference that the exemption and modification

16 Subregulation 7.9.19A(3).

> power granted to ASIC under Part 7.6 does not apply to provisions in Divisions 4 and 8 of that Part.[17]

2.28 However, ASIC's proposed power (in section 926A) was considered by the Senate Standing Committee for the Scrutiny of Bills. This Committee has advised that section 926A:

> may be considered to delegate legislative powers inappropriately, in breach of principle 1(a)(iv) of the Committee's terms of reference, and may be considered to insufficiently subject the exercise of legislative power to parliamentary scrutiny, in breach of principle 1(a)(v) of the Committee's terms of reference.[18]

2.29 Proposed regulation 7.6.08 is made under proposed section 926B and seeks to modify the operation of section 923A of the Act. Section 923A allows persons providing a financial service 'to assume or use a restricted word or expression' or, more colloquially, to hold themselves out as being 'independent, impartial or unbiased' but only if, among other things, commissions received are rebated in full to clients.

2.30 Practical difficulties have arisen in the implementation of section 923A where financial services providers cannot locate clients and thus meet the requirement to rebate commissions to them. In these circumstances, the proposed regulation makes adjustments which allow financial services providers to use a restricted word or expression if they have taken all reasonable steps to locate the client and, in the event of failure, pay the commission to ASIC.

2.31 The proposed regulation also modifies the operation of section 926B to apply to financial services providers regardless of whether initially, their business practices were not such as to satisfy the 'restricted word or expression' requirements. The Revised Explanatory Memorandum says in this regard that:

> The current operation of section 923A is an absolute in that it does not allow for a person to modify their practices over time so that they may satisfy the requirements of the section 923A and be permitted to use restricted terms in relation to new clients or financial services. A regulated person's prior business practices and pre-existing client relationships effectively prevent them from utilising the restricted terms the limitations described in section 923A(2) at any time in the future.[19]

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17 Financial Services Reform Amendment Bill 2003, Revised Explanatory Memorandum, Parliament of the Commonwealth of Australia, Senate, p. 22.

18 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest No.8 of 2003*, 13 August 2003, pp.17-18.

19 Corporations Amendment Regulations Commentaries, Schedule 2 Item [5].

Regulation 7.7.08A—Combined Financial Services Guide and Product Disclosure Statement

2.32 Proposed section 942DA of the Financial Services Reform Amendment Bill 2003 allows the Financial Services Guide (FSG) and Product Disclosure Statement (PDS) to be combined into a single document but only as provided by regulations made for the purposes of the section.

2.33 The importance of ensuring combined documents comply with the regulations is underlined in the Revised Explanatory Memorandum which states that:

> Combining a FSG and PDS contrary to the conditions set out in the regulations will result in a minor penalty being applicable under paragraphs 952I(1)(b) and 952I(2)(b) and subparagraph 1021(1)(b)(i). The combined document will also be subject to the offence provisions for being 'defective' and will be required to be presented in a 'clear, concise and effective' manner as stipulated in subsections 942B(6A) and 1013C(3).[20]

2.34 The circumstances in which a FSG and PDS may be combined into a single document are when:

- the providing entity for the financial service and the product issuer for a product issued in relation to the service provided are the same person; or
- the providing entity for the financial service is a representative or a related body corporate of the product issuer; and
  - the product is a basic deposit product, a non-cash payment facility, a general insurance or life risk insurance product; and
  - the combined document clearly and prominently states the identity of the providing entity and the product issuer, the nature of their relationship and the liability of the providing entity and product issuer in relationship to the document.

2.35 Other requirements of a combined FSG and PDS are that:

- it must be divided into 2 separate parts which are clearly identifiable and satisfy the requirements of a FSG and PDS respectively (although cross-referencing is permitted);
- the title, 'Combined Financial Services Guide and Product Disclosure Statement', appears near or at the front of the document; and
- the document is provided to a client at the earlier of when a FSG or PDS must be provided.

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20 Paragraph 3.98, p. 23.

2.36 The Explanatory Statement for the proposed regulation states that the combined document 'should achieve a balanced outcome of reducing printing costs for industry while maintaining disclosure documents at a high standard.'[21]

21 Corporations Amendment Regulations Commentaries, Schedule 2 Item [6].

CHAPTER 3

EVIDENCE TO THE INQUIRY

3.1 The Committee received seven submissions to the inquiry, and took evidence from seven organisations at its public hearing. With the exception of the Australian Consumers' Association, all submissions and evidence supported the legislation and urged the Committee to recommend its urgent passage through the Senate.

Issues raised in submissions and evidence

3.2 The following aspects of the legislation were supported in evidence:

- Amendments to section 912D (AFSL breach notification);[1]
- Amendments to section 912F(1) and regulations in Batch 6, relating to specification of the documents requiring AFSL numbers;[2]
- Amendments relating to basic deposit products;[3]
- Amendments to section 946B relating to Statements of Advice and Further Market Related Advice;[4] and
- Modifications to section 923A and regulation 7.6.08 relating to exemption and modification powers, and the use of restricted terms such as 'independent'.[5]

3.3 The following aspects of the legislation attracted some concern:

- New subparagraph 1020E(1)(a)(i) which allows ASIC the power to issue stop order notices where a Product Disclosure Statement is not worded and presented in a clear, concise and effective manner;[6]
- Regulation 7.6.08 which relates to the use of the term 'independent' and which may, according to the Australian Consumers' Association, confuse consumers or erode their confidence in the integrity of the term 'independent';[7]

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1 Submission 1, Investment & Financial Services Association Ltd, p. 2.

2 Submission 1, Investment & Financial Services Association Ltd, p. 2; Submission 5, Australian Association of Permanent Building Societies, p. 2.

3 Submission 3, Credit Union Services Corporation Industry Association, p. 2; *Transcript of Evidence*, National Credit Union Association; Submission 4, Australian Bankers' Association, p. 2.

4 Submission 2, Securities & Derivatives Industry Association, p. 1.

5 Submission 7, Financial Planning Association, p. 2; Submission 4, Australian Bankers' Association, p. 3.

6 Submission 1, Investment & Financial Services Association Ltd, p. 2.

7 *Transcript of Evidence*, Australian Consumers' Association.

- The Australian Consumers' Association expressed concern that the dollar disclosure proposals in regulations 7.7.11, 7.7.12, 7.7.13, 7.9.15A and 7.9.75, which introduce a new disclosure regime for fees based on the concept of what is 'reasonably practicable' (from the fund or product issuer's perspective) and which:

    a) Wind back the disclosure requirements in relation to periodic statements and other disclosure documents for fund members and investors;

    b) Are contrary to the good disclosure principles in ASIC Policy Statement 168; and

    c) Mean that consumers are unlikely to obtain the very information that they need when it comes to comparing funds and costs;[8]

- Regulation 7.6.02A relating to the requirement that AFSL holders report breaches of laws administered by APRA to ASIC, thus resulting in a double reporting requirement;[9] and
- Regulation 7.9.07J appears not to have recognised a situation where two products that together form a single product and where providing the customer with a single product statement would be an advantage to the customer.[10]

Other concerns

3.4 Evidence from Burrell Stockbroking raised concerns about the enactment of criminal penalties for section 945A. In particular, Mr Burrell argued that the legislation does not fit the situation of stockbrokers who may be asked for advice in relation to particular matters, but whose clients do not wish to be provided with full service financial advice.[11]

3.5 Mr Burrell supported the amendments on Further Market Related Advice, but suggested that the current legislation as a whole is based on a 'false industry model' insofar as it relates to the stockbroking industry.

Committee view

3.6 The Committee notes that all but one witness argued for the urgent passage of the bill and associated regulations by the Senate.

3.7 The Committee considers that the Corporations Amendment Regulations 2003 (No.8) 2003 No.282 (Batch 5) are appropriate.

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8 *Transcript of Evidence*, Australian Consumers' Association.

9 Submission 3, Credit Union Services Corporation Industry Association, p. 2.

10 Submission 4, Australian Bankers' Association, p. 4.

11 Submission 6, Burrell Stockbroking; *Transcript of Evidence*, Burrell Stockbroking.

3.8 The Committee proposes no amendment to Draft Corporations Amendment Regulations 2003 (No.) (Batch 6).

Recommendation

The Committee recommends that the Senate pass the Financial Services Reform Amendment Bill 2003, containing government amendments agreed to in the House of Representatives, as a matter of urgency.

Senator George Brandis
Chairman

Labor Members Minority Report

Government Amendments to the *Financial Services Reform Amendment Bill*

Corporations Amendment Regulations 2003 (no. 8) statutory rules 2003; no. 282 (previously known as Batch 5)

Batch 6 of the Corporations Amendment Regulations 2003 (draft regulations)

FSR Regime

The Labor members reiterate their support for the objectives of the *Financial Services Reform Act 2001* (the "*FSR Act"*) and are keen to ensure that the Government monitors the implementation of the Act and the related regulations.

Accordingly, the Labor members recommend a review of the FSR regime post-implementation in 2004.

The Labor members have a number of concerns with the *Financial Services Reform Amendment Bill 2003* (the "*FSRA Bill*") which are detailed in the Senate Economics Committee Report tabled on 21 August 2003.

The Labor members also have a number of concerns with the latest Government amendments to the *FSRA Bill* and regulations including:

- whether the "stockbroker exemption" strikes an appropriate balance between commercial expediency and consumer protection;
- whether the "dollar disclosure" regime will enhance or detract from the disclosure regime; and
- whether it's appropriate to restrict the use of certain terms such as "independent" in the manner contemplated by the regulations.

Hearing and Timing

The conduct of this hearing raises a number of concerns.

The first concern is that insufficient notice was given to relevant witnesses. The hearing was called with only a few days notice so many relevant witnesses were unable to attend. Significantly, no representatives from the superannuation industry were able to attend the hearing due to the short notice time.

Also, the hearing was incomplete which means that not all of the relevant issues were considered by the Committee.

Another concern relates to timing.

The Labor members are extremely concerned that at five minutes to midnight the Government continues to make substantial changes to a key piece of amending legislation in relation to the FSR regime.

As of 2 December, the ASIC website notes that there is only eight days to go until 10 December and after that date, there's no guarantee that participants will be licensed by 10 March 2004.

Although the March 2004 deadline is approaching, the Government brought the bill on for debate in the House of Representatives on 5 November 2003. In addition, the last batch of amendments were posted on the Treasury website on 23 October 2003 whilst the latest batch of regulations were provided by Treasury in late October. Further regulations are expected to follow.

This has created uncertainty in the financial services industry which has had an impact on the willingness of some participants to transition to the new FSR regime.

Also, the FSR regime is structured such that much of the detail is included in the regulations. As the regulations are continuing to be drafted, Labor members of the Committee and other Senators are put in a position where they are asked to pass legislation without knowing how the amendments will operate in practice as the detail (contained in the regulations) is outstanding.

Stockbroker Exemption

Currently, section 946B relates to "executive-related telephone advice (ERTA). However, the latest batch of government amendments replace this concept with a new term: "further market related advice" (FMRA).

This provision relates to advisers providing financial product advice but will be particularly relevant to stock brokers.

The key amendments to section 946B will mean that although the client will be given a Statement of Advice (SoA) initially, the provider will be exempt from the requirement to give a SoA for "further market related advice".

The "further market related advice" may given over the telephone, by fax or by email but the advice must given in a "live" market situation.

The Labor members support the general approach taken by the amendments and recognise the practical difficulties that are faced by advisers in a "live" market situation.

However, the Labor members are concerned about whether an appropriate balance has been struck between commercial expediency and consumer protection.

The Government's amendment assumes that the broker will be making regular enquiries about their client's personal circumstances and so will be in a position to know if those circumstances do in fact change.

Section 945A provides a general obligation for entities to have a reasonable basis for any personal advice given which (according to the Explanatory Memorandum) requires them to determine the client's relevant personal circumstances.

The Labor members query whether this general requirement is sufficient in this context. It's unclear how an adviser such as a stockbroker would be aware whether their clients' circumstances have in fact changed.

Accordingly, in our view the new provision should include a requirement that the broker is required to go back to the client at least annually to check whether their circumstances have changed.

The interesting point about the provision is that even though the broker is no longer required to provide a SoA, they are still required to make other disclosures relation to issues like remuneration and conflicts of interest.

Dollar Disclosure

Outline of amendments

Corporations Amendment Regulations 2003 (no. 8) statutory rules 2003; no. 282 (previously known as Batch 5) are of particular importance to the superannuation and funds management industry as they introduce a new fee disclosure regime.

The new fee disclosure regime is based on the "dollar disclosure" proposals contained in regulations 7.7.11, 7.7.12, 7.7.13, 7.9.15A and 7.9.75.

Disclosure documents under the *FSR Act* (such as Statements of Advice, Product Disclosure Statements and periodic statements) are required to include details of benefits, fees and charges.

Currently, the *FSR Act* requires parties to provide "information about" these charges.

But there is a lack of clarity as to what actually needs to be disclosed. The Explanatory Memorandum for the regulation says:

> *"The lack of clarity in this requirement may potentially result in details of these items being provided in a form that may be considered sub-optimal from a consumer comprehension viewpoint."*

Accordingly, these regulations require industry to disclose items in dollar terms in the first instance but if this is not 'reasonably practicable' then the item is required to be disclosed in percentage terms.

If presentation as a percentage is not reasonably practicable, then a description of how the item is determined must be provided.

Reasonably practicable

The Labor members are concerned that the "reasonably practicable" test will allow providers to avoid disclosing fees and charges in dollar terms. It seems that the "reasonably practicable" test will facilitate industry expediency in relation to fee disclosure at the expense of consumer protection.

During the Senate Economics Committee hearing the Australian Consumers Association (ACA) expressed concern that the new "dollar disclosure" regime (as set out in the regulations) would "wind back" some the requirements for disclosure of fees and charges.

Ms Wolthuizen said that the ACA had the following concerns:

> *"First of all, I think it would see not only a denial of relevant information contrary to the good disclosure principles enunciated by ASIC in PS 168 that disclosure be timely, relevant and complete, promote product understanding, promote comparison, highlight important information and have regard to consumers' needs, but in this case it would mean consumers are unlikely to get the very information they need when it comes to comparing different funds and the cost in particular of investing with different funds and different products."*

The importance of disclosure in dollar terms cannot be underestimated – as consumers understand disclosure in dollar terms.

Ms Wolthuizen said that:

> *"I also think that the regulation as currently drafted casts disclosure from an industry expediency perspective by relying on a "reasonably impracticable" requirement rather than the clear, concise and effective overarching requirement of the legislation. While it may be appropriate to taken into account practical considerations when looking at such things as breach notifications, which are also included in the regulations, when it comes to giving consumers information that they can actually understand, survey after survey and study after study shows that individual dollar based disclosure provided on a standardised basis is most effective."*

The release of the ANZ national survey of Adult Financial Literacy in May highlighted the difficulty that many consumers face in understanding fees and charges which apply to their investments, particularly superannuation. The survey found that:[1]

[1] ANZ Media Release, *ANZ releases Australia's first financial literacy survey,* 2 May 2003.

- 56% of people did not know their fees and charges relating to superannuation well; and
- 60% of people could not identify key items on a superannuation statement correctly.

Industry has also come to the conclusion that effective fee disclosure is required. Earlier this year, the Chairman of the Investment and Financial Services Association (IFSA), Mr Doug McTaggart said that:

> *"I am concerned that our industry will be seen to have created a supply side driven monster that is out of control. A monster that has too many product features, too many different types of fees and too little effective disclosure. I marvel at how the average politician, regulator or consumer can get their head around our various products and services. Is it any wonder that we are under constant criticism? The industry needs to focus on simplifying its offerings….. if it is not possible to quantify a fee in a product disclosure statement of financial services guide, we should consider banning that fee."*

Professor Ramsay's recommendations

The concept of disclosing dollar amounts where "reasonably practicable" does not sit with Professor Ramsay's recommendations in his report *"Disclosure of Fees and Charges in Managed Investments"*.[2]

The ACA told the Committee that:

> *"Looking at the Ramsay recommendations in his report, I think there are substantial problems and substantial variations in fee disclosure currently provided to fund members. In his view it was extremely concerning. If we allow a "reasonably practicable" definition of what is required, it is difficult to see how in many cases that would be advanced. If you do not require people to move forward where it is not considered to be in their best interests to do so, I think it would be used as an excuse. Reasonably practicable according to what – according to cost, according to having to change stationery and letterhead..? Yes it would create a much more lax regime than Professor Ramsay envisaged and I think than consumers expect."*

One argument against enhanced fee disclosure relates to the cost.

However, as Professor Ramsay noted in his report, in the US the *United States General Accounting Office* has calculated that the cost of providing improved disclosure of fees and charges in investor annual statements would be less than $1 per investor per year.

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[2] Professor Ian Ramsay, *Disclosure of Fees and Charges In Managed Investments, Review of Current Australian Requirements and Options for Reform: Report to the Australian Securities and Investments Commission*, 25 September 2002.

Professor Ramsay has said that fee disclosure in relation to periodic statements is particularly important as they may be more closely read than PDSs as they:

> *"give details of the value of the existing investment and the investor has a financial incentive to review the statement."*

Choice Environment

Ms Wolthuizen also noted the importance of disclosure in an environment of superannuation choice saying that:[3]

> *"Clearly if we wind back from a dollar disclosure regime that is tailored to an individual account, we are going to lose not only the application of good disclosure principles but also the capacity for consumers to understand how much they are paying to be a member of a particular fund. This will be particularly important we move along the track to a superannuation choice of fund regime. I think it is reasonable to ask what might precipitate a fund member to decide to switch funds. One will be a change of empower. The other likely to be the receipt of an annual statement showing poor returns or high costs associated with the product they are currently invested in."*

A matter of time

One of the arguments expressed by Treasury in the Explanatory Memorandum is that dollar disclosure will become more widespread over time. The Explanatory Memorandum says that:

> *"It is anticipated that generally industry's capacity to disclose information in dollar terms will increase over time as systems are developed and products evolve. Consequently, the disclosure of amounts in dollar terms is expected to become more widespread over time."*

The Labor members do not share Treasury's optimism.

The ACA share Labor's scepticism about industry voluntarily disclosing dollar amounts saying that:

> *"One of the arguments in the explanatory statement on the regulations [is] that it is likely that dollar based disclosure will evolve if industry is left to work out more effective sways of disclosing, I see no evidence in the development of fee disclosure so far to suggest that that will be the case. I highlight to the committee the fact that the US Congress last week passed the US Mutual Funds Bill to require greatly enhanced disclosure requirements of industry there."*

[3] Transcript of Evidence, p. E16.

The Labor members believe that consumers require disclosure of fees and charges in dollar terms.

The "reasonably practicable" test will allow product issuers to choose the way in which they disclose fees and charges which will result in inconsistent disclosures. This means that investors will be unable to compare 'like' products - which seriously impacts on their ability to make informed investment decisions.

Other Disclosure Models

In August ASIC released a fee disclosure model which contained a so called 'at a glance table' for disclosure of fees in PDSs.

Labor Senators' Conroy and Sherry expressed concern that ASIC's table did not allow investors to compare 'like with like' as:

- Product issuers can choose to describe fees in dollar terms or as a percentage;
- Product issuers can choose to show fees as gross or net of tax;
- There is no requirement to report the "single bottom line" figure; and
- The model is principles-based so there is the potential for enormous inconsistencies in information provided by different product issuers.

Many of these concerns have been reiterated by the research conducted by ASFA with Chant West which was released in November.

The Chant West report found that:[4]

> *"…it is not clear that consumers will be able to understand ASIC's fee tables or make valid comparisons of bottom-line costs."*

The Chant West report makes a number recommendations to improve fee disclosure and the ASIC model. The recommendations include:

- producing a single fee that is comparable between funds and between different types of funds;
- requiring that fees should always be shown gross of income tax and inclusive of GST; and
- requiring that any commissions or fees included in insurance premiums should be clearly detailed and that commission paid to the issuer should be distinguished from commission paid to the advisers.

The Parliamentary Secretary, Mr Ross Cameron issued a media release on 13 November 2003 welcoming this research. He said that:

[4] ASFA/Chant West, *Fees Research,* November 2003.

> *"At a time of significant change in the transition to the Financial Services Reform Act it is vital that industry and consumer bodies continue to come together to share ideas to benefit greater consumer understanding. The Government will await the presentation of ASFA's consumer testing research results to ASIC and other members of the group for their joint consideration as part of the on-going collaborative approach to implementing the FSR disclosure requirements."*

The Labor members are of the view that changes to the fee disclosure model are required.

Restricted terms

The other key area of concern relates to the proposal in the *Batch 6 of the Corporations Amendment Regulations 2003* (draft regulations) relating to restriction of certain terms such as the term "independent".

The ACA advised the Committee that:

> *"I think we need to be extremely cautious about any capacity to downgrade the integrity of the label "independent" with regard to independent or non-independent provision of financial planning advice. This is something that has certainly emerged as a key issue, given the sensitivities around the quality of advice highlighted by the ACA-ASIC survey. It was very clear in the aftermath of the release of that survey that consumers attach a high importance to the label "independent".*

In relation to consumers views on the term "independent" the ACA advised that:

> *"I think we also need to be very clear about what consumers actually understand and expect from the term "independent'…It would be extremely concerning if consumers were confused or had their confidence in the integrity of the term eroded upon becoming aware that someone whom they expected would be independent and free from external influences had in fact also offered financial planning services that were not independent during that transition period."*

ASIC monitoring of such a provision was also raised. The ACA said that:

> *"In our view there is also a need for very careful monitoring of how the exemption would be granted. I think this would be an area where close scrutiny by ASIC of those using the term "independent" would be warranted."*

The Labor members endorse the comments by the ACA.

Senator Ursula Stephens
Deputy Chair

Appendix 1

Submissions Received

Submission Number	Submittor
1	Investment & Financial Services Association Ltd
2	Securities & Derivatives Industry Association
3	Credit Union Services Corporation Industry Association (CUSCAL)
4	Australian Bankers' Association
5	Australian Association of Permanent Building Societies
6	Burrell Stockbroking
7	Financial Planning Association of Australia Limited

Appendix 2

Public Hearing and Witnesses

Monday, 1 December 2003 Canberra

BURRELL, Mr Christopher Thomas, Managing Director
Burrell Stockbroking Pty Ltd

CLARK, Mr Doug, Policy Executive
Securities and Derivatives Industry Association

ELLIOTT, Mr Philip, Chief Executive Officer
National Credit Union Association

FRENCH, Mr Philip Gardner, Senior Policy Manager
Investment and Financial Services Association Ltd

GILBERT, Mr Richard, Chief Executive Officer
Investment and Financial Services Association Ltd

HRISTODOULIDIS, Mr Con, National Manager
Policy and Government Relations,
Financial Planning Association of Australia Ltd

LAWLER, Mr Luke, Senior Adviser, Policy and Public Affairs
Credit Union Services Corporation (Australia) Ltd

PETSCHLER, Ms Louise Margaret, Head of Public Affairs
Credit Union Services Corporation (Australia) Ltd

ROSSER, Mr Mike, Manager, Investor Protection Unit
Corporations and Financial Services, Department of the Treasury

WOLTHUIZEN, Ms Catherine Nicole, Senior Policy Officer
Financial Services, Australian Consumers Association