

The Senate

Economics Legislation Committee

Provisions of the Financial Services Reform
Amendment Bill 2003

August 2003

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ISBN 0 642 71277 8

Senate Economics Legislation Committee

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Secretariat

Dr Sarah Bachelard, Acting Secretary
Mr Phillip Bailey, Acting Principal Research Officer
Mr Matthew Lemm, Research Officer
Ms Judith Wuest, Executive Assistant

Suite SG.64

Parliament House
Canberra ACT 2600

Ph: 02 6277 3540

Fax: 02 6277 5719

E-mail: economics.sen@aph.gov.au

Internet: http://www.aph.gov.au/senate/committee/economics_ctte/index.htm

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CHAPTER 1

INQUIRY INTO THE FINANCIAL SERVICES REFORM AMENDMENT BILL 2003

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.

Purpose of the Bill

1.2 The *Financial Services Reform Act 2001* (FSR Act) commenced on 11 March 2002. It amended the *Corporations 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.

1.3 The amendments to the *Corporations 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 *Corporations Act 2001*. It will also make minor amendments to the *Income Tax Assessment Act 1997* and the *Retirement Savings Accounts Act 1997*.

Reference of the Bill

1.4 On 25 June 2003, the Senate adopted the Selection of Bills Committee report No. 7 of 2003 and referred the Bill to the Senate Economics Legislation Committee for report by 19 August 2003.

Submissions

1.5 The Committee advertised its inquiry in *The Australian* on 2 July 2003. It also wrote to a number of individuals and organisations, including the Treasury and the Australian Securities and Investments Commission. They were alerted to the inquiry and invited to make a submission. A list of the parties from whom submissions were received appears at Appendix 1.

1.6 The Committee received seven submissions. All submissions supported various aspects of the Bill. Some submissions suggested further amendments to the *Corporations Act 2001*.

Hearing and evidence

1.7 The Committee held one public hearing on this inquiry in Parliament House, Canberra on 30 July 2003. Witnesses who appeared before the Committee at that hearing are listed in Appendix 2.

1.8 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

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

CHAPTER 2

BACKGROUND TO THE BILL

2.1 This chapter outlines the main provisions of the Bill.

Purpose of the Bill

2.2 The *Financial Services Reform Act 2001* (FSR Act) commenced on 11 March 2002. It amended the *Corporations 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.

2.3 The amendments to the *Corporations 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 transition into the new arrangements. To this end the Bill will clarify and amend various aspects of Chapter 7 and related provisions of the *Corporations Act 2001*. It will also make minor amendments to the *Income Tax Assessment Act 1997* and the *Retirement Savings Accounts Act 1997*.

Substantive changes made by the Bill

2.4 The Bill makes a variety of technical and substantive changes to the FSR regime. To assist in the analysis of comments made by submissions, the substantive changes will be briefly outlined.

Schedule 1 – Amendments of the Corporations Act 2001 relating to unsolicited offers to purchase financial products off-market

Amendment of section 760B and Part 7.9 of Chapter 7 (heading)

2.5 The Bill will amend the heading of Part 7.9 and a citation of the heading to reflect that Part 7.9 disclosure provisions are to apply to the purchase of financial products in addition to sales.¹

1 Financial Services Reform Amendment Bill 2003, *Explanatory Memorandum* p5

Division 5A of Part 7.9 is to apply to securities

2.6 Amendments to section 1010A of the FSR Act ensure that new division 5A will apply to all financial products including securities.²

Division 5A of Part 7.9 is to apply to financial products not issued in the course of a business

2.7 Amendments to section 1010B of the FSR Act ensure that new division 5A will operate in relation to financial products issued in the course of a business, as well as financial products not issued in the course of a business.³

Unsolicited offers to purchase financial products off-market

2.8 The Bill establishes a disclosure regime for unsolicited off-market offers to purchase financial products. The disclosure regime applies when a person makes an unsolicited offer to purchase a financial product from another person and that offer is made other than on a licensed financial market. In addition:

- The regime only applies where the offer is made in the course of a business of purchasing financial products; or
- the offer is made where the offeror is not in a personal or business relationship with the offeree.
- Regulations can further specify where an offer will fall into this regime.

2.9 Where an offer falls into the disclosure regime:

- the person making the offer will be required to disclose in the offer document the current market value of the financial products they make off-market offers to purchase.
- Where the current market value is not available, for example where a financial product is not traded on a licensed financial market, then the offeror must provide a 'fair estimate' of the value of the product, and explain in the offer document how the estimate was arrived at.
- The relevant offer must be made in printed or electronic form. Unsolicited offers by other means such as by telephone, are prohibited. Offers are to remain open for at least one month but not more than 12 months.
- The disclosure regime will apply to offers and counter-offers but not an 'invitation to treat'.

2 Ibid

3 Ibid

- In the event of a defective offer, for 30 days after the contract was entered into, the offeree has the right to terminate the contract and refuse to transfer the financial product to the offeror or to have it returned.⁴

ASIC Stop Orders

2.10 In relation to the disclosure regime of Division 5A of Part 7.9, ASIC will have stop order powers, particularly where an offer document is defective (eg it contains misleading or deceptive content).⁵

Civil liability

2.11 In the case of a defective offer document, but the offeror no longer holds the financial product, civil recourse is available to the offeree.⁶

Disclosure provisions will apply during transition period

2.12 The new disclosure provisions commence upon Royal Assent, rather than at the end of the transition period.⁷

Schedule 2 – Other Amendments of the *Corporations Act 2001*

Definition of ‘basic deposit product’

2.13 The definition of ‘basic deposit product’ will be expanded to include deposit products with a term of five years or less. 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’.⁸

Expert statements in exempt documents

2.14 The provision of a recommendation, statement of opinion or report in an exempt document will not avoid the licensing requirements merely because it is contained in an exempt document.⁹

4 Ibid at p5,6

5 Ibid at p6

6 Ibid

7 Ibid

8 Ibid at p7

9 Ibid at p8 see subclause 766B(1A) of Bill

Definition of ‘dealing’

2.15 Under the current law, section 766C, provides the power to make regulations as to what is not dealing, the Bill will provide the power to also make regulations as to what dealing *is*.¹⁰

ASIC’s exemption and modification powers

2.16 Under various provisions of Chapter 7 and Part 10.2, powers to provide exemptions from, or make modifications to, the application of certain provisions of the Act are given to ASIC.¹¹ The powers provided to ASIC generally contain the limitation that they may not be exercised by ASIC to declare that provisions are modified such that they apply in relation to persons and/or financial products to which they otherwise would not apply.¹²

2.17 ASIC uses these powers to provide administrative ‘relief’ from the operation of the legislation in circumstances where it judges that application of those provisions is not warranted, or that they should be apply in a modified way. This may occur, for example, where the strict operation of the legislation may produce unintended or unreasonable results.

2.18 The example provided in the *Explanatory Memorandum* cites a case of several insurance brokers who were effectively denied the benefit of the 2 year transition period to the new licensing regime in the FSR Act, because they failed to lodge the renewal of their registration in accordance with the rigid time limits of the *Insurance (Agents and Brokers) Act 1984*. In this case, the limitation on ASIC from applying its modification powers in relation to a person to whom the laws didn’t otherwise apply, meant ASIC was not able to provide the relief sought. The Bill will remove the existing limitation which presently prevents ASIC from declaring that a provision is modified such that it applies to a person and/or financial product to which it would not otherwise apply.¹³

Licensing exemption for services regulated by overseas regulatory authorities

2.19 The Bill will amend the ability of ASIC to provide an exemption from licensing under the FSR Act for a person regulated by an overseas regulatory body. Proposed paragraph 911A(2)(h) will effectively allow ASIC to provide such an exemption where the person is regulated by an overseas regulatory authority, and the service is provided only to wholesale clients.

10 Ibid at p.8.

11 Ibid at p..9. see sections 951B, 992B, 1020F, 1075A in Chapter 7 and sections 1437 and 1442 in Part 10.2

12 Ibid at p.9. see subsections 951B(2), 992B(2), 1020F(3) and paragraphs 1437(3)(b) and 1442(3)(b)

13 Ibid at p.11.

Reporting of breaches to ASIC

2.20 The Bill will amend the requirement under the FSR Act for AFSL holders to report to ASIC breaches, or likely breaches, of obligations set out in sections 912A and 912B. The amendments will include:

- Changing the reporting requirements to apply to an AFSL holder who ‘has breached or is likely to breach’ the relevant obligations. This change does not change the FSR Acts current basic requirements, but seeks to make it clearer;
- The basic reporting period is extended from 3 days to 5 business days;
- Only ‘significant’ breaches will be required to be reported to ASIC (factors to be considered in assessing significance are listed in subparagraph 912D(1)(b); and
- The requirement to report breaches or likely breaches of financial services laws, will include the current definition of financial services laws (defined in s 761A of the FSR Act) and those laws of the Commonwealth that are specified in regulations created for the purpose of proposed paragraph 912D(1)(b).

AFSL Number on Specified Documents

2.21 Section 912F of the Bill creates a strict liability offence for failure to include a person’s AFSL number on documents connected with providing financial services under the licence. To ensure certainty regarding what documents must include an AFSL number, a regulation making power is provided.¹⁴

2.22 This amendment was supported in submissions.¹⁵

Notification of the appointment of authorised representatives

2.23 The Bill extends the time period within which the appointment of authorized representatives must be notified under s 916F(1) and (1A), from 10 to 15 business days.

2.24 The Bill also inserts a new subsection 916F(1AA) the effect of which is to provide that the appointment of certain individual authorised representatives (IAR) by a corporate authorised representative (CAR) does not have to be notified to ASIC if:

- The IARs are members of a specified class of individuals;
- The appointment of which has the consent of the license holder;
- The IARs are employees of the CAR; and

14 Ibid at p.16.

15 *Submission 1*, Australian Association of Permanent Building Societies, p.3; *Submission 2*, Association of Superannuation Funds of Australia p.1.

- The IARs are only authorised to provide general advice in relation to, and/or deal in, financial products specified in the regulations (it is envisaged that general insurance products will be specified).¹⁶

Exemption from the requirement to provide a Financial Services Guide for certain basic deposit and other products

2.25 Section 941C lists situations in which a Financial Services Guide (FSG) is not required. Subsection 941C(6) provides an exemption from the requirement to provide a FSG for certain basic deposit and other products. The Bill will clarify the scope of the exemption by specifying dealing and the provision of product advice as activities that are covered by the exemption.¹⁷

Ability to combine disclosure documents

2.26 The Bill will make amendments to allow a FSG and a product disclosure document (PDS) to be combined into a single document in certain circumstances. These circumstances will be specified in regulations. ASIC may facilitate combined documents in specified circumstances by the use of a declaration under s 951B.¹⁸

Money held on trust

2.27 Under the current law sections 981H(1) provides that client moneys paid to a licensee are taken to be held on trust by the licensee. Section 981(2) provides that s 981H(1) does not apply where the licensee and client agree in writing that the money shall not be held on trust. The Bill repeals s 981(2) and makes associated changes in order to ensure that parties can't contract out of the obligation that money be held on trust (the original intention of the section had been to not override any express trust created by the parties).¹⁹

Situation where a PDS not required

2.28 The Bill provides that the obligation to give a PDS does not apply in circumstances where prospective members of a self managed superannuation fund have the information available to them to make an informed decision.²⁰

SMSFs not required to lodge an 'in-use' notice

2.29 The Bill will make amendments such that trustees of SMSFs will not be required to lodge 'in use' notices.²¹

16 Ibid at p.16.

17 Ibid at p.17.

18 Ibid

19 Ibid at p.20.

20 Ibid at p.21.

Periodic statements for retail clients

2.30 An amendment to paragraph 1017D(5)(c) inserts a regulation making power to enable the specification of requirements relating to the disclosure of information for transactions.²²

2.31 Concerns were expressed by ASFA that there is a lack of clarity as to whether section 1017D and regulation 7.9.75 require periodic statements to include details of individual transactions.²³ They recommend in their submission that regulations made under proposed paragraph 1017D(5) address issues of clarity, cost, practicality and consumer comprehension in the transaction requirements for periodic statements.²⁴

Stop order for breach of the ‘clear, concise and effective’ presentational requirement

2.32 The Bill grants ASIC the power to issue stop orders where there is a breach of the ‘clear, concise and effective’ requirement.²⁵

21 Ibid

22 Ibid at p.23.

23 *Submission 2*, at p.3.

24 Ibid

25 Ibid at p.23.

CHAPTER 3

EVIDENCE PRESENTED TO THE INQUIRY

3.1 The Committee received seven submissions to the inquiry. Comments made by submissions included support for various aspects of the Bill, as well as several concerns. This chapter begins with aspects of the Bill which were supported in submissions but were not subject to further comment. Following this are the issues which led to further discussion or comment.

Aspects of the Bill supported in submissions

3.2 Submissions expressed support for the following aspects of the Bill:

- the power to make regulations as to what *is* dealing, as well as to what is not dealing (proposed s 766C(7));¹
- specifying dealing and the provision of product advice as activities covered by the exemption from providing an FSG covered by section 941C;² and
- the removal of the requirement for Self Managed Superannuation Fund (SMSF) trustees to lodge an ‘in use’ notice with ASIC;³

Issues raised in submissions

3.3 Submissions offered comment on the following aspects of the Bill:

- expanded definition of ‘basic deposit product’;
- ASIC’s exemption and modification powers;
- exemption and modification powers regarding Part 7.6;
- reporting of breaches to ASIC;
- AFSL number on specified documents;
- notification of the appointment of authorised representatives;
- ability to combine disclosure documents;
- periodic statements for retail clients;
- circumstances where self managed superannuation fund trustees not required to give PDS;

1 *Submission 1*, Australian Association of Permanent Building Societies, p.3.

2 *Submission 1*, at p.3.

3 *Submission 2*, at p.1.

- Section 1012G of the *Corporations Act 2001*; and
- regulatory differences between retail and wholesale providers.

Definition of ‘basic deposit product’

3.4 The Bill would expand the definition of ‘basic deposit product’, to include term deposit products of five years or less that are not at call. Currently the definition of basic deposit product is limited to two year deposit products.

3.5 This amendment was widely supported in submissions.⁴ Submissions noted that the Joint Committee on Corporations and Securities recommended in its report on the Financial Services Reform Bill that deposit products offered by authorised deposit taking institutions (ADIs) be removed entirely from the definition of financial product in the bill.⁵ The Australian Association of Permanent Building Societies (AASPBS) noted:

This was recommended in part to ensure the viability and level of services of ADI agencies in rural and regional areas. The Committee Report noted that the disclosure and training requirements associated with more complex financial products – which are by nature investment products – were inappropriate for deposit products where there have been few concerns expressed about inadequate consumer protection.⁶

3.6 CUSCAL stated in their submission that if a term deposit product was unable to meet the requirements of being a ‘basic deposit product’ there would be onerous regulatory requirements imposed on service providers. They argued that the inability to meet the at-call requirement of the definition could require a teller talking to a customer about a fixed term deposit product (eg a “Christmas club account”) to have a financial planner’s diploma and to provide an FSG and a PDS.⁷ The Committee acknowledges the value of such products for the community, and believes there should be an appropriate balance between effective protection of consumers without reducing the range of products offered consumers.

3.7 The Australian Association of Permanent Building Societies argued that if the definition of ‘basic deposit product’ was not extended to include 5 year term deposits (ie. deposits that are not at call), then there would be less choice available to consumers:

4 *Submission 1*, Australian Association of Permanent Building Societies, p.1.-2.; *Submission 3*, Credit Union Services Corporation, p.2.; *Submission 4*, Bendigo Bank, p.1.-2. *Submission 5*, Australian Bankers’ Association, p.2.

5 *Submission 1*, Australian Association of Permanent Building Societies, p.1.; *Submission 3*, Credit Union Services Corporation, p.2.; *Submission 5*, Australian Bankers’ Association, p.2.

6 *Submission 3*, Credit Union Services Corporation, p.1.

7 *Submission 3*, Credit Union Services Corporation, p.3.

What we are saying is that the tendency of the institutions – certainly the ones we represent – will be to pull back from five years and only offer the short term. Therefore, you are reducing choice for consumers.⁸

3.8 The Australian Bankers' Association (ABA) supported this argument, noting that the vast majority of term deposits have a maturity profile of two years or less, and that if the basic deposit product class is limited to two years, service providers will be discouraged from offering consumers the option of a longer term deposit.⁹

Committee view

3.9 The Committee believes that extending the class of basic deposit products to include all term deposits of five years or less will create a uniform level of compliance for term deposits, thus reducing compliance costs for service providers and increasing the choice of investment terms for consumers.

ASIC's exemption and modification powers

3.10 The Bill makes various amendments to the powers granted to ASIC to make exemption and modification to the application of certain provisions of the Act and to exercise exemption and modification powers through the making of regulations.¹⁰

3.11 Under the current law ASIC's exemption and modification powers cannot be exercised in relation to a party to whom the law would not otherwise apply.¹¹

3.12 In the *Explanatory Memorandum* several examples are given of circumstances where ASIC has been unable to exercise exemption and modification powers, where it would have been good policy to do so; it was, however, limited because such an exercise would have been causing the Act to apply where it otherwise would not have.¹² The Bill would remove this restriction.

3.13 The Bill would insert new sections 926A and 926B, which would respectively provide for exemptions and modifications to be made by ASIC and the regulations, in respect of the application of Part 7.6.¹³ These powers relate to all of Part 7.6 (Licensing of providers of financial services) except for Division 4 (Australian financial services licenses) and Division 8 (Banning or disqualification of persons from providing financial services).

8 *Transcript of Evidence*, Larkey, J., pE34

9 *Submission 5*, p. 3.

10 See Para 3.30 – 3.85, 3.103 – 3.104 and 3.111 - 3.120 of the *Explanatory Memorandum*

11 Sections 951B, 992B, 1020F, 1075A in Ch. 7 and sections 1437 and 1442 in Part 10.2 of the Act.

12 See *Explanatory Memorandum*, para 3.69 – 3.75

13 Item 42 of the Bill, see para 3.103 – 3.104 of the *Explanatory Memorandum*.

3.14 Treasury explained the background to these amendments in the hearing:

The approach taken by the bill is to look at areas where greater flexibility is desirable to enhance the transitional period. In that regard I should note that the provisions being proposed are not different in kind from provisions that exist in other parts of chapter 7 and also in other parts of the Corporations Act.... I probably should say that they do not foreshadow specific regulations or exemptions necessarily. It is more a matter of providing the capacity within the legislation to respond to issues as they arise, particularly during the critical last six to eight months of the transition period.¹⁴

3.15 The Committee notes that the exemption and modification powers granted to ASIC by proposed section 926A were considered by the Senate Standing Committee for the Scrutiny of Bills, which stated:

In respect of proposed new section 926A, the Committee **seeks the Minister's advice** as to why such a power has been conferred on the Australian Securities and Investments Commission, and whether the powers of exemption and modification granted by the proposed new section 926A should not be exercised by regulation rather than by the Commission.

*Pending the Minister's advice, the Committee draws Senator's attention to the provision, as it 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.*¹⁵

Committee view

3.16 The Committee believes that any delegation of power from the Parliament should be subject to thorough consideration and scrutiny, and notes that the Senate Standing Committee for the Scrutiny of Bills is awaiting advice from the Minister as to why such power should not be exercised by regulation rather than by ASIC.

Exemption and modification powers regarding Part 7.6

3.17 Amongst other things, this would grant exemption and modification powers to ASIC in relation to the use of the term 'independent'.

3.18 In additional correspondence provided to the Committee, CPA Australia supported such powers as they argued that a large proportion of its members are independent, but are unable to call themselves such, due to the strict operation of the

14 *Transcript of Evidence*, Rosser, M. p.E56.

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

legislation.¹⁶ This problem was also voiced by Treasury, who explained in the hearing that many advisers are unable to call themselves independent, even where they rebate all commissions, if for example, they are unable to return any moneys due to administrative errors (eg the lack of a forwarding address).¹⁷

3.19 At the hearing, Treasury was specifically asked what form the regulations relating to the term ‘independent’ may be in:

[W]e would be trying to put in place a practical result of the legislative intent. If a person in large part is independent and for various operational reasons is unable to use that term, which they arguably should be permitted to, the regulation-making power would enable regulations to be made to achieve that.¹⁸

Committee view

3.20 For consumers to be able to make informed decisions when seeking financial advice, it is essential that they can assess the independence of a financial adviser. For this reason it is essential that the integrity of the term is maintained. On the other hand, access to the term should not be precluded from parties who would otherwise be able to use it, purely because of administrative or technical issues. For this reason the Committee supports granting the regulator the power to apply the intent of the legislation and ensure the term is applied in an appropriate manner.

Reporting of breaches to ASIC

3.21 Under the Bill, Australian Financial Services License (AFSL) holders will only have to report breaches (or likely breaches) of the Act to ASIC if they are ‘significant’. Currently all breaches, however technical must be reported. This amendment was supported by ASFA in its submission.¹⁹ ASFA explained that under the current law, it is arguable that a bank would have to notify ASIC if an ATM was to ‘go down’. They also explained that superannuation funds may be required to notify ASIC in the event of non-consequential technical administrative errors.²⁰

3.22 Treasury explained that the requirement that the breach be ‘significant’ will ensure that the intended effect (ie. compliance) will be achieved, without imposing an excessive compliance cost on parties.

16 Additional information provided to Committee, correspondence between CPA Australia and the Committee, dated 11 August, 2003.

17 *Transcript of Evidence*, Rosser, M, E59.

18 *Transcript of Evidence*, Rosser, M. p.E59.

19 *Submission 2*, at p.1.

20 *Transcript of Evidence*, Pragnell, B. p.E36,E37.

The importance of this area is to focus the mind of the licensee on its obligation to comply with the law. The requirement to report noncompliance is, if you like, an incidental to that. It is important but nevertheless incidental. The primary objective is to require the licensee to comply with its licensing obligations, including a requirement to comply with the relevant law.²¹

Committee view

3.23 The Committee believes that the amendments will overcome the possibility of unintended administrative burden, whilst achieving the original policy intent of ensuring compliance.

AFSL number on specified documents

3.24 The imposition of a strict liability offence to ensure that AFSL numbers are included on documents provided in relation to services rendered under an AFSL license was supported in submissions.²²

3.25 In the hearing, ASFA explained that the new provision, including the regulation making power, would provide certainty: 'I think superannuation fund trustees would like certainty in terms of which documentation does contain the AFSL and which does not. At the moment it is uncertain... people would like certainty so they can make decisions about when they have to destroy old documents and issue new documents.'²³

Committee view

3.26 The Committee believes that the amendments will assist AFSL holders by providing clarity as to what documents need to contain an AFSL number.

Notification of the appointment of authorised representatives

3.27 Submissions supported the amendments to the time period and notification requirements relating to authorised representatives,²⁴ although the Australian Bankers' Association contended that further relief is needed. The Association expressed the

21 *Transcript of Evidence*, Rosser, M. p.E62.

22 *Submission 1*, Australian Association of Permanent Building Societies, p.3; *Submission 2*, Association of Superannuation Funds of Australia p.1.

23 *Transcript of Evidence*, Pragnell, B. p.E38.

24 Proposed s 916F(1) and (1A) and s 916F(1AA) were supported in *Submission 5*, Australian Bankers' Association, p.4.; *Submission 4*, Bendigo Bank, p.2.

concern of member banks that where temporary staff are employed (eg. through third party employment agencies), the employment agency will be required to notify ASIC of the names of those individuals.²⁵

3.28 It was also noted that banking services are often provided by banks through agency or franchise arrangements (particularly in rural and regional areas) and in these cases the compliance costs may act as a disincentive for providing these services.²⁶

3.29 This issue was further discussed in the hearing. The ABA was asked how it would suggest overcoming this issue.²⁷ It acknowledged the difficulty of finding a balance:

It is a difficult one to solve, because I think there is a risk of opening up a loophole and one needs to be careful about that. There would need to be some recognition of the types of structures that are now in place.

3.30 This issue was raised with Treasury in the hearing, and they explained that such issues may be addressed through the regulation making powers:

[I]t is sometimes difficult to frame something in the legislation itself without perhaps opening up interpretational problems, where a regulation or perhaps an ASIC declaration could be a bit more discursive and give a bit more background to what is trying to be achieved. A lot of the changes in this bill have resulted from the fact that some of the legislation we thought covered certain things turned out not to. It is an example where some flexibility could be needed to try and address that sort of issue.²⁸

3.31 Treasury explained that it was because of these sorts of concerns that the Explanatory Memorandum noted that insurance products would be specified in regulations.

[T]his is where we thought the problems were arising. In insurers, where they typically have call centres and they might employ several hundred or even thousand staff, notifying ASIC of each individual authorised representative would be excessively onerous without any commensurate [benefit]... the principle essentially is that, if the identity of the individual is not particularly relevant, then whether or not that individual needs to be notified is the question. There are instances, particularly in call centres, where the identity is not particularly relevant, and it is obviously most relevant to general advice.²⁹

25 *Submission 5*, Australian Bankers' Association, p.4.;

26 *Submission 5*, Australian Bankers' Association, p.4.; *Submission 4*, Bendigo Bank, p.2.

27 *Transcript of Evidence*, Gilbert, I. p.E47.

28 *Transcript of Evidence*, Maher, D. p.E63.

29 *Ibid.*

Committee view

3.32 The Committee believes that this measure strikes a balance between reducing unintended administrative costs and ensuring effective compliance.

Ability to combine disclosure documents

3.33 The Bill will make amendments to allow a FSG and a product disclosure document (PDS) to be combined into a single document in certain circumstances. These amendments were supported by the Australian Association of Permanent Building Societies.³⁰

3.34 ASFA explained at the hearing that its members also support the change.

[T]hey would like to be able to provide a single document to new members, which would include all of the information about them both as a licensee and as a financial product issuer. So there will be a single document there that says: who we are, what we do, and this is our product.³¹

3.35 At the hearing Treasury were asked to specify in what circumstances the regulations would be likely to allow a combined FSG and PDS:

Those situations are with the Office of Legislative Drafting at the moment. We would intend them to be very limited in terms of preserving what the separate FSG and what the separate PDS is. Obviously we would not want a combined document that is basically a kaleidoscope of things—a bit of the FSG, a bit of the PDS and so on. We are intending to base our relief on certain work that ASIC have done on their policy statement 175. We want to ensure that the elements of the FSG and the PDS are preserved, are easily accessible, and yet give business the flexibility in certain circumstances to provide a combined document.³²

Committee view

3.36 The Committee notes Treasury's comments that any regulations made in this regard would ensure that the effective content of a combined PDS and FSG would not be reduced, rather the form would be streamlined. The Committee supports the combining of documents, if the integrity and accessibility of information is maintained for consumers.

30 *Submission 1*, p.3.

31 *Transcript of Evidence*, Pragnell, B. p.E39.

32 *Transcript of Evidence*, Yik, A. p.E63.

Periodic statements for retail clients

3.37 An amendment to paragraph 1017D(5)(c) inserts a regulation making power to enable the specification of requirements relating to the disclosure of information for transactions.³³

3.38 Concerns were expressed by ASFA that there is a lack of clarity as to whether section 1017D and regulation 7.9.75 require periodic statements to include details of individual transactions.³⁴ They recommended in their submission that regulations made under proposed paragraph 1017D(5) address issues of clarity, cost, practicality and consumer comprehension in the transaction requirements for periodic statements.³⁵

3.39 At the hearing ASFA acknowledged the value that a bank account style statement might have for consumers, and explained that the issue is one of clarity and certainty for the industry ‘we do not oppose moving towards that type of regime, but I think we want to make sure that people have clarity... that there are some concessions and that people have time to do it.’³⁶

Committee view

3.40 The Committee believes that the regulation making power will allow appropriate regulations to provide clarity and certainty regarding what form periodic statements must take.

Circumstances where self managed superannuation fund trustee not required to give PDS

3.41 The Bill provides that the trustee of a self-managed superannuation fund (SMSF) will not be required to give a prospective member a PDS where the trustee has reasonable grounds to believe that the prospective member has received or knows they have access to, all of the information required in the PDS.

3.42 The Financial Planning Association of Australia submitted that it supported providing relief to SMSF trustees, but felt that the amendment did not go far enough, as the SMSF trustee could still breach the law if it was unable to have a ‘reasonable basis’ for believing the member had access to the information in a PDS. They noted

33 *Explanatory Memorandum*, p.23.

34 *Submission 2*, at p.3.

35 *Ibid*

36 *Transcript of Evidence*, Pragnell, B. p.E41.

that many SMSFs are family based arrangements, and the administration is often outsourced to a service provider.³⁷

3.43 In support of the amendment, ASFA acknowledged that minimising the burden on SMSF trustees has to be balanced against protecting prospective members:

[I]t is a matter of trying to find a compromise between two extreme positions. I think most of us recognise that a trustee director of a single-member, self-managed fund giving themselves a PDS is a bit of a ridiculous situation. But at the opposite extreme we need to recognise that a full exemption of self-managed funds from the PDS regime is going a bit too far in the other direction.³⁸

Committee view

3.44 The Committee supports the amendment and believes that the exemption reduces the administrative burden on SMSF trustees, whilst still ensuring that prospective members at least have access to the information necessary for them to make an informed decision.

Section 1012G

3.45 The Australian Bankers' Association noted that prior to the introduction of the Bill, the government had indicated that there would be amendments to section 1012G included in the Bill, these would remove the requirement that a client be read a prepared statement in lieu of providing them with a PDS. The ABA indicated they would support such a measure, subject to an opportunity to make a more informed submission upon seeing the detail of such a proposal.³⁹

3.46 In the hearing the ABA explained that one of its members has submitted that the time it takes to read out the information required under s 1012G is 3 ½ minutes; the ABA argued that this was problematic where services may be delivered over a long distance telephone call.⁴⁰

What we are looking for is not to take away the customer receiving some information over the phone and being directed to where they can get hold of the full document, but perhaps streamlining it—it is a time and space exercise—so that the customer is not turned off listening to this monologue but at the same time is getting some realistic information or is able to go somewhere and find it. When we see the amendment we will obviously wait to see whether those types of issues are picked up.⁴¹

37 *Submission 7*, Financial Planning Association of Australia, p.2.

38 *Transcript of Evidence*, Pragnell, B. p.E39.

39 *Submission 2*, p.5.

40 *Transcript of Evidence*, Gilbert, R. p.E47.

41 *Ibid.*

Committee view

3.47 The Committee notes that Treasury is considering this issue.

Regulatory differences between retail and wholesale providers

3.48 The International Banks and Securities Association of Australia (IBSAA) made a submission detailing various concerns regarding the regulatory differences between retail and wholesale providers.⁴² Concerns included the possibly inappropriate classification of some entities as retail clients⁴³ and uncertainty in applying the retail client definition.⁴⁴

3.49 Treasury noted in the hearing that these concerns related to fundamental aspects of the FSR legislation and were outside the scope of the amendments in this Bill.⁴⁵ They stated that they were consulting with IBSA about the practical application of the Act and the concerns raised in its submission.⁴⁶

Committee view

3.50 The Committee notes Treasury's comments that it is consulting with IBSA to address the concerns raised in its submission.

Possible amendments to the Bill

3.51 The Committee notes that the Government has proposed to move amendments to the Bill when it is debated in the Parliament.⁴⁷

Conclusion

3.52 The Bill seeks to streamline the transition process into the new regulatory arrangements introduced by the *FSR Act*. To enable flexible regulation under the new regime, the Bill grants extended modification and exemption powers to ASIC. The Committee notes the various commitments by Treasury that these extended powers are to allow the original policy intent of the regime to be effected, rather than extend the Act beyond its original scope.

42 *Submission 6*, International Banks and Securities Association of Australia

43 *Submission 6*, at p.3.

44 *Submission 6*, at p.6.

45 *Transcript of Evidence*, Rosser, M. p.64.

46 *Ibid.*

47 See Appendix 3.

Recommendation

The Committee recommends that the Bill be passed.

SENATOR GEORGE BRANDIS
Chairman

LABOR MEMBERS MINORITY REPORT

Financial Services Reform Amendment Bill 2003

Introduction

The Labor members of the Committee support 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 *Financial Services Reform Amendment Bill 2003* (the “Bill”) makes changes to various aspects of the FSR regime.

The areas of concern for the Labor members include:

- the expansion of the definition of “basic deposit product”;
- the expansion of ASIC’s exemption and modification powers; and
- the expansion of the regulation making powers.

Basic Deposit Products

Background

The definition of the term “basic deposit product” has a long history.

In August 2000, the Parliamentary Joint Statutory Committee on Corporations and Securities (as it was then known) recommended that deposit products offered by Authorised Deposit-taking Institutions (ADI’s) should be removed from the definition of financial product.¹

Instead of exempting all deposit products, the Government decided to exempt deposit products offered by ADI’s, for terms of 2 years or less with no management or break fees.

The amendment was intended to ensure that:

¹ Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Draft Financial Services Reform Bill*, August 2000.

“the final Bill’s requirements apply in such a way that it recognises that basic deposit products are generally well understood by retail consumers and that consumers can get their money back on demand.”²

In August 2001, the Parliamentary Joint Statutory Committee on Corporations and Securities (as it was then known), concluded that the Government’s concession did not go far enough and recommended again that the exemption should apply to *all* basic deposit products.

In the August 2001 Minority Report, the Labor members did not support the Chair’s recommendation that the Bill exempt basic deposit products from the definition of financial product on the basis that there would be significant benefits to consumers from requiring providers of basic deposit products to be competent to provide those services.

Current proposal

The Bill expands the definition of ‘basic deposit product’ to include:

- deposit products with a term of five years or less; and
- deposit products which are not ‘at call’.

The definition of “basic deposit product” is important as the FSR Act has relaxed requirements in relation to these products.

For example:

- There is no requirement to give the consumer an Financial Services Guide (FSG) or a Statement of Advice (SOA); and
- Recent amendments to ASIC Policy Statement 146 have *removed* the need for basic deposit product (BDP) and Non-Cash Payment facilities (NCPFs) training courses to be assessed by an authorised assessor and placed on the ASIC Training Register.

Authorised deposit taking institutions have consistently argued that basic deposit products should be excluded from the FSR regime. Although, recently it’s been reported that the banks have given up on obtaining a total exemption.³

The argument advanced by the ADI’s for including deposit products with a term of up to 5 years in the definition of “basic deposit products” relates to the cost of providing such products.

² Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Financial Services Reform Bill 2001*, August 2001, p. 6.

³ Joyce Moullakis, *Banks give in on exemptions – for now*, The Australian Financial Review, 14 July 2003.

The ADI's argue that the imposition of training and compliance costs and the production of financial services guides and statements of advice, associated with providing term deposits of more than two years, were so great that ADI's would not continue to offer such products, thereby reducing choice for consumers.

The ADI's also argued that these products made up a small part of their business.

In a supplementary submission to the Committee, the Australian Bankers Association (ABA) state that:⁴

"...term deposits of more than two years represent a very small percentage of a bank's total term deposit portfolio.... The overwhelming number and value of term deposit accounts are in the two years or less category."

The Labor members note the concerns of the ADI's in relation to compliance costs and the limited demand for these products.

However, in spite of the fact that term deposits of more than two years make up a small segment of the term deposit market and create compliance costs, the nature of these products must be considered.

A term deposit of more than two years is a significant investment for a consumer.

The Labor members are of the view that the expanded definition of basic deposit product may lock consumers into a long term investment without an appropriate level of protection. For example, if consumers choose to invest in a term deposit of five years, they are then locked into that product and may even roll that initial investment into a further 5 year investment.

Conclusion

The Labor members reiterate their view that basic deposit products have already received significant concessions under the new regulatory regime which aim to minimise paperwork and administrative costs.

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.

Therefore, the Labor members do not support the Committee's view that the definition of basic deposit products should be expanded.

ASIC's Exemption and Modification Powers

The Bill expands ASIC's powers to make exemptions and modifications in two ways:

⁴ Australian Bankers Association, Submission to Senate Economics Committee, 12 August 2003.

- By removing an existing limitation on ASIC's power; and
- By inserting a new provision giving ASIC the power to grant relief in relation to the licensing provisions and/or modify their application (discussed below).

The bill inserts a new provision (section 926A) that allows ASIC to give exemptions and modifications in relation to the licensing of providers of financial services (Part 7.6).

This power will allow ASIC to exempt companies from parts of Part 7.6 and modify or clarify its operation (ASIC already has the power to exempt companies from the whole of Part 7.6⁵).

ASIC will be able to exercise this power without the need for a disallowable instrument, that is, without the sanction of Parliament. The devolution of power away from Parliament is a matter of concern for the Labor members.

The bill also inserts a new regulation making power in relation to Part 7.6 (section 926B). This will allow the Government to make regulations in relation to Part 7.6 (which by their nature may be disallowed by Parliament). Therefore, in the event that the Government decided to grant relief or make concessions or modify the application of this provision, the issue would be considered by Parliament.

ASIC are of the view that:

“Without one or both of a regulation-making powers or ASIC exemption and modification powers, there will be no efficient and timely means to address these likely Part 7.6 issues.”⁶

Whilst either the Government or ASIC may require a power to modify the application of Part 7.6, it's not clear why *both* ASIC and the Government require similar powers to modify the operation of Part 7.6.

The regulation making power which can be exercised by the Government is subject to Parliamentary scrutiny (as it may be subject to a disallowance motion) whereas the power given to ASIC is not.

ASIC's proposed power (in section 926A) was considered by the Senate Standing Committee for the Scrutiny of Bills. This Committee have advised that section 926A:⁷

⁵ ASIC has a limited licensing exemption power in section 911A.

⁶ Letter from Mr Ian Johnston (Executive Director, Financial Services Regulation, ASIC) to Mr Michael Rosser, (Investor Protection Unit, Treasury) 14 August 2003 (attached to the Letter from Mr Michael Rosser to the Senate Economics Committee dated 15 August 2003 relating to questions taken on notice).

⁷ Senate Standing Committee for the Scrutiny of Bills, *Alert Digest No. 8 of 2003*, 13 August 2003, p. 17-18.

“..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.”

The Committee for the Scrutiny of Bills has sought the Minister’s advice:⁸

“...as to why such a power has been conferred on the Australian Securities and Investments Commission, and whether the powers of exemption and modification granted by the proposed new section 926A should not be exercised by regulation rather than by the Commission.”

The Labor members share the Committee for the Scrutiny of Bills’ concern and recommend that consideration be given as to whether to remove the proposed power provided to ASIC under section 926A.

Expanding the Regulation making powers

The Bill expands the Government’s power to make regulations by inserting new regulation making powers into Parts 7.6, 7.7, 7.8 and 7.10.

The new powers will enable exemptions and modifications via regulations in relation to these Parts.

The Labor members acknowledge the FSR Regime has been structured such that much of the detail has been made by regulation.

The Explanatory Memorandum states that:⁹

“..the legislation was designed to make use of regulations to provide greater detail and specificity in relation to particular products and situations as appropriate. This two-tiered approach was a fundamental structural element of the FSR Act.”

The Labor members are of the view that whilst regulations provide flexibility for the application of the FSR regime it is important to recognise that the regulations, as subordinate legislation, attend to matters of administration and detail and not general principles.

Independence

The Explanatory Memorandum notes that the regulation making power proposed for Part 7.6 will permit modifications to section 923A in relation to restrictions on the use

⁸ *Ibid*

⁹ Explanatory Memorandum, *Financial Services Reform Amendment Bill 2003*, p. 18.

of certain words, such as independent, unbiased and impartial.¹⁰

During the hearing, Treasury officials advised the Committee that this regulation is currently being drafted and that:¹¹

“the regulations that are being contemplated are very much at the margin. They do not go to a substantial change to the operations.”

Treasury advised the Committee that the regulations would apply in a situation where a financial planner lost contact with a client as a result of the client moving and the planner was unable to rebate the commission in full to the parties. In this case, Treasury said that the financial planner should still be able to use the term “independent” even though they were in this instance unable to rebate the commission.

The Labor members note that the issue of “independence” is a critical issue for the financial services industry and will require in-depth consideration.

Senator Ursula Stephens
Deputy Chair

¹⁰ Explanatory Memorandum, *Financial Services Reform Amendment Bill 2003*, p. 19.

¹¹ Senate Economics Legislation Committee, Hansard, 30 July 2003, p. E59.

Appendix 1

Submissions Received

**Submission
Number**

Submitter

- | | |
|---|--|
| 1 | Australian Association of Permanent Building Societies |
| 2 | Association of Superannuation Funds of Australia Ltd (ASFA) |
| 3 | Credit Union Services Corporation (CUSCAL) |
| 4 | Bendigo Bank |
| 5 | Australian Bankers' Association |
| 6 | International Banks and Securities Association of Australia (IBSA) |
| 7 | Financial Planning Association of Australia Limited |
| 8 | Investment & Financial Services Association Ltd (IFSA) |

ADDITIONAL INFORMATION

Additional information received from International Banks and Securities Association of Australia.

Additional information received from Credit Union Services Corporation

Additional information received from Australian Association of Permanent Building Societies

Additional information received from CPA Australia

Additional information received from Australian Bankers' Association

Further additional information received from Australian Bankers' Association

Additional information received from Treasury with attachments from the Australian Securities and Investments Commission (ASIC)

Appendix 2

Public Hearing and Witnesses

Wednesday, 30 July 2003, Canberra

GILBERT, Mr Ian, Director, Retail Policy, Australian Bankers Association

HODGE, Mr Robert, Senior Policy Adviser, The Association of Superannuation Funds of Australia

LARKEY, Mr James, Executive Chairman, Australian Association of Permanent Building Societies

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

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

MAHER, Mr Dave, Analyst, Investor Protection Unit, Department of the Treasury

PRAGNELL, Dr Bradley John, Principal Policy Adviser, The Association of Superannuation Funds of Australia

ROSSER, Mr Michael John, Investor Protection Unit, Corporations and Financial Services Division, Department of the Treasury

VENGA, Mr Raj Ashwinn, Director, Policy and Regulatory Affairs, Australian Association of Permanent Building Societies

WILESMITH, Mr Brett, Analyst, Investor Protection Unit, Department of the Treasury

YIK, Mr Andrew Yu Chin, Analyst, Investor Protection Unit, Department of the Treasury

