

Senate Select Committee on Superannuation and Financial Services

Main Inquiry Reference (a)

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**Submission
to the Senate Select Committee on Superannuation and
Financial Services**

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On behalf of

AUSTRALIAN CONSERVATION FOUNDATION

ENVIRONMENT VICTORIA

FRIENDS OF THE EARTH AUSTRALIA

GREENPEACE AUSTRALIA

THE WILDERNESS SOCIETY

JOHN POPPINS- Coordinator BHP Shareholders for Social responsibility
THE ETHICAL INVESTMENT TRUST (A Community Aid Abroad Initiative)

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1. Introduction

In May of this year we prepared a submission in response to the Government's *Draft Financial Services Reform Bill*. The submission was forward to Treasury and submitted for consideration by the Joint Statutory Committee on Corporations and Securities.

The submission focused on part 7.8 of the *Draft Financial Services Reform Bill*, which outlines the uniform disclosure obligations to be inserted into the *Corporations Law* relating to all financial products provided to retail clients. The submission recommended that the disclosure obligations for financial products with an investment component be expanded to include a requirement that at the point of sale of those products, the seller or issuer of the product disclose to the retail client:

The extent (if at all) to which, environmental, social or ethical considerations are taken into account in the selection, retention and realisation of the investments.

This submission, although it is for the most part identical in content to our earlier submission, has been prepared specifically for the Senate Select Committee on Superannuation and Financial Services as it raises issues and provides recommendations that we feel fall within the Committee's terms of reference and are worthy of its consideration.

2. Draft Financial Services Reform Bill

The *Draft Financial Services Reform Bill* (the draft "FSR Bill") puts into effect proposals contained in the Government's Corporate Law Economic Reform Program 6 ("CLERP 6"). It will put in place a regulatory framework, within the provisions of the *Corporations Law*, for the financial services industry covering a wide range of **financial products**, including securities, derivatives, general and life insurance, superannuation, deposit accounts and non-cash payment accounts. The draft FSR Bill provides for:

- ❖ Uniform regulation of all financial products;
- ❖ A single licensing framework for financial service providers;
- ❖ Minimum standards of conduct for financial service providers dealing with retail clients;
- ❖ **Uniform disclosure obligations for all financial products provided to retail clients;** and
- ❖ Flexibility for authorisation of market operators and clearing and settlement facilities.

3. Uniform Disclosure Obligations

This submission relates primarily to the uniform disclosure obligations contained in part 7.8 of the draft "FSR Bill." Broadly speaking part 7.8 provides for:

- (A) Point of sale disclosure through the giving of a product disclosure statement;
- (B) Ongoing disclosure obligations; and
- (C) Periodic reporting requirements.

3.1 Point of Sale Disclosure

Whilst welcoming the general intent of the disclosure obligations contained in part 7.8 of the draft FSR Bill, it our submission that the proposed provisions relating to point of sale disclosure are currently insufficient to carry out its primary objective.

The commentary to the draft FSR Bill states that “the broad objective of the point of sale disclosure obligations is to provide consumers with sufficient information to make informed decisions in relation to the acquisition of financial products, including the ability to compare a range of products.”

The draft FSR Bill attempts to achieve this objective by requiring the issuer or seller of financial products (with the exception of securities) to provide to a retail client, at the point of sale of those products, a Product Disclosure Statement (“PDS”).

A PDS, as currently proposed, is required to disclose to a retail client, details of such things as:

- ❖ The name and contact details of the product issuer;
- ❖ Benefits the retail client might be entitled to;
- ❖ Risks;
- ❖ Amounts payable by the retail client;
- ❖ Commissions payable by the retail client;
- ❖ Dispute Resolution;
- ❖ Tax implications;
- ❖ Cooling off information;
- ❖ Any other significant characteristics or features; and
- ❖ Other information the product issuer or seller ought reasonably to expect to have a material influence on the decision of a reasonable retail person to acquire the product.

Primary Recommendation:

We recommend that the compulsory disclosure details contained in a PDS for a *financial product with an investment component* be expanded to include the following:

The extent (if at all) to which, environmental, social or ethical considerations are taken into account in the selection, retention and realisation of the investments.

Financial products with an investment component would include superannuation products, managed investment products and products dealing with an investment component of life insurance.

4. Reasons for Primary Recommendation

This part (4) attempts to answer three questions that might be asked in relation to the primary recommendation of this submission.

4.1 Why expand the disclosure details at the point of sale through a PDS?

The point of sale disclosure is the most critical period for disclosure. It is when consumers make the informed decision to purchase a particular product based on the information before them.

What's more, if the content of information supplied in a PDS should change in any material way, the ongoing disclosure provisions currently proposed in the draft FSR Bill, would require the disclosure of those changes to the consumer.

We do note however, that managed investment products are not subject to the ongoing disclosure requirements on account of them being subject to the current ongoing disclosure requirements contained in sections 1001A-D of the *Corporations Law*. Should it be found that sections 1001A-D are not sufficient to require a managed investment entity to disclose any changes to its "ethical investment policy," we recommend that managed investment entities be brought within the ongoing disclosure requirements of the draft FSR Bill.

Recommendation:

Should it be found that sections 1001A-D of the *Corporations Law* are not sufficient to require a managed investment entity to disclose any changes to its "ethical investment policy," we recommend that managed investment entities be brought within the ongoing disclosure requirements of the draft FSR Bill.

4.2 Why expand the disclosure requirements for only the financial products with an investment component?

The primary recommendation of this submission relates only to financial products with an investment component. We have defined such products to include superannuation products, managed investment products and products dealing with an investment component of life insurance.

These products are "functionally equivalent." They consist of an investment component through which consumers of the product are seeking to generate a high return. They also carry with them a higher degree of risk for the investor than would an investment in such products as interest bearing bank accounts.

Most importantly, they possess the common characteristic of a product through which the consumer has no control over the day to day use of the money invested to generate the return. It is this final common characteristic that justifies the obligation on the

issuer or seller of financial products with an investment component to be subject to a more rigorous disclosure regime.

4.3 Why disclose ethical investment policies?

This submission's primary recommendation, broadly speaking, would require the disclosure of the ethical investment policies (if any) governing financial products with an investment component. Such disclosure is required in response to:

1. Consumer demand;
2. The imminent changes to the superannuation industry; and
3. The new and emerging role of the financial services sector as a vehicle for wider corporate environmental and social responsibility.

4.3.1 Consumer Demand

There can be no denying recent international and domestic trends, which point to a growing consumer demand for ethical investment products. For example:

- ❖ In the United States screened (ethical) portfolios in 1999 were worth US \$1,497 billion in comparison to US \$529 billion in 1997. This represents a growth rate being twice that of the general market. *Social investment forum, November 1999.*
- ❖ In the UK, the ethical investment market has seen similar growth experiencing a 47.7% growth rate between 1997 and 1998 (*Financial Times*).
- ❖ In Australia, it is estimated that \$250 million is invested in ethical investment funds (Carolyn Batt the Sunday Age, 14 May). Industry specialists believe that ethical investment in Australia will follow US and UK trends and grow to become a multi billion dollar industry in the next five years (Anne- Marie Dark CEO of HESTA superannuation, quoted in the Sunday Age, 14 May).

Consumers are not only investing in ethical investment products because of a perceived benefit for the environment and society as a whole. They are now viewing ethical investment as carrying less risk than so called "unscreened" investments whilst providing the potential for higher returns. For example, Australian Ethical Investments posted a 25.7 per cent profit on its large company share strategy in the first nine months since its inception to September 1999 (Australian Ethical Superannuation Key Feature Statement, November 1999).

If consumers are now demanding ethical investment products, it is essential that they be provided with sufficient information to enable them to differentiate between an ethical and an unscreened investment product at the point of sale.

4.3.2 Imminent Changes to the Superannuation Industry

Superannuation is now compulsory for the vast majority of Australian employees. It now covers 97% of full time Australian employees and 81% of all employees (Westpac Investment Management Manual: *An Overview of Screened Investments and the Potential for Shareholder Value*). The latest Australian Prudential Regulatory Authority (APRA) statistics show that superannuation assets in Australia totalled

\$415 billion as at December 1999. The Federal Government's Retirement Unit estimates that this figure is set to double by the year 2010.

There is increasing evidence which suggests that compulsory superannuation has forced Australians to now consider the way in which their money is invested with many people now demanding greater control over their compulsory savings.

For example, research conducted by HESTA, Australia's fourth largest superannuation fund in membership, has shown that there is a strong demand amongst its members for an ethical investment option. This research suggests that Australia is now following the US trend where "screened ethical investments" now attract 10 per cent of superannuation savings. In response to such research, HESTA has become the first mainstream superannuation fund to offer an environmental investment choice with the launch of its new product "eco pool" (Carolyn Batt, *the Age*, Tuesday, 2 May 2000.).

Government too, is responding to employee calls for greater investment choice. The Commonwealth government in 1998 tabled the *Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 1998*. The overall purpose of the choice of fund Bill is to give employees greater choice as to the superannuation funds into which their compulsory contributions are made. As the law currently stands, employees are required to make superannuation contributions to the fund chosen by their employer.

Within this background, ethical investment policy disclosure at the point of sale of superannuation products has never been more critical. It is particularly required in the instance of superannuation because firstly, it is compulsory for the vast majority of consumers to invest in a superannuation product and secondly, consumers will soon be given greater choice as to which product their compulsory savings might be invested in. In light of this, one could say that it would in itself be "unethical" if the Government were not to create the legislative framework to ensure that the true nature of a superannuation product is adequately disclosed to the consumer.

Australia would not be the first country to introduce such disclosure requirements for superannuation. The disclosure requirements contained in this submission's primary recommendation are based on the disclosure obligations imposed on Trustees of UK pension funds recently introduced by way of an amendment to the UK *Pensions Act 1995*.

4.3.3 The Role of the Financial Services Sector as a Vehicle for Corporate Environmental and Social Responsibility

In late February of this year, Melbourne was host to the United Nations Environment Program ("UNEP") Financial Services Conference. The Conference was the first such forum to be held in Australia and was attended by representatives from many organisations that offer investment products, often referred to as "institutional investors." The conference highlighted the emerging recognition that Australia's institutional investors have a vital role to play in promoting wider corporate environmental and social responsibility.

With their enormous pooled wealth, institutional investors can exert a powerful influence over the behaviour of other corporate entities simply through a decision to direct their investment funds to corporations that have a sound environmental and social philosophy and away from those that do not. By directing investment away from corporations that cause environmental or social harm, it will leave those companies without the investment capital that is necessary to continue such harmful activities.

Requiring institutional investors to disclose their ethical policies will ensure that consumers are able to ascertain which investment product is truly an ethical product. This in turn will assist and promote those entities that offer ethical investment products in performing their valuable role as a vehicle for wider corporate environmental and social responsibility.

5. Conclusion

The objectives of the Draft FSR Bill can only be fully realised if the compulsory disclosure details contained in a PDS for a financial product with an investment component are expanded to include the following:

The extent (if at all) to which, environmental, social or ethical considerations are taken into account in the selection, retention and realisation of the investments.

This is necessitated by consumer demand, imminent changes to superannuation laws and the assistance it will provide to institutional investors that act as a vehicle for wider corporate environmental and social responsibility.