IFSA
Investment & Financial Services Association Ltd
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15 March 2010

Regulatory Burdens: Business and Consumer Services
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

By email: regulatoryburdens@pc.gov.au

Dear Sir/Madam

RE: ANNUAL REVIEW OF REGULATORY BURDENS ON BUSINESS

Thankyou for the opportunity to provide input to the annual Productivity Commission review of regulatory burdens on business. The review provides a good opportunity to identify inefficient and unnecessary business costs resulting from either legislative or regulatory actions or simply from market developments that render current legal requirements inappropriate or simply obsolete.

IFSA is the peak body representing Australia's retail and wholesale funds management, superannuation and life insurance industries. IFSA has over 135 members who are responsible for investing over $1 trillion on behalf of more than ten million Australians.

To put the scale of our industry in perspective, our funds under management are larger than the GDP of Australia and the capitalisation of the Australian Stock Exchange. In international terms, Australia has the fourth largest pool of managed funds in the world.

We have attached a summary identifying certain regulatory burdens, our recommendations and a short statement explaining the basis for each recommendation.

Over the last two federal electoral cycles, IFSA has issued a regulatory headland statement with the primary objective of identifying what IFSA members consider to be necessary legislative changes to be addressed by the incoming Government over a three year term. A number of recommendations in those papers have been acted on. Attached for your information are copies of the IFSA Headland Statements *IFSA – Towards Better Regulation* (23 February 2006) and *IFSA -Towards a More Efficient Regulatory System: 2008 – 2011*,

In the IFSA 2006 Regulatory Headland Statement it was estimated that the then current cost for IFSA member companies to comply with the financial service industry regulation is about 10 to 15% of total operational costs. Given that even minor regulatory changes now generally involve some changes to the technology and operational systems

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underpinning the delivery of products and services, the compliance costs of relatively small regulatory changes may be quite high. The Committee, on behalf of the industry, must seek to ensure that the costs of change do not exceeded the perceived benefits.

IFSA considers that regulatory burdens can be best addressed through robust consultative arrangements. This has been a focus in each of the last two Regulatory Headland Statements. IFSA's previously expressed view is that the current consultative in respect of legislative/regulatory proposals will continue to operate in a somewhat 'ad hoc' fashion and lack any structure or arrangements for accountability unless a more formal consultative structure is adopted. As with any area of endeavour, improvements can always be made and, we believe, a better system for consultation can be built. Such a proposal was included in the IFSA 2006 Regulatory Headland Statement and more recent recommendations were included in the November 2009 Report of the Australian Financial Centre Forum on *Australia as a Financial Centre – Building on our Strengths*.

We would be pleased to provide further information and further assistance if required

Regards

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REGULATORY BURDENS

The following is a list of specific matters that represent current significant regulatory issues for the Investments, Superannuation and Insurance industries. The list is not exhaustive and does not indicate any order of importance. The matters raised do highlight the nature of the problems and issues faced by business.

The following provides detail on a number of operational matters that carry significant regulatory burden or where there is cost that outweighs the benefit to investors, members and policy holders.

Managed Investments & Superannuation

1. Binding Death Nominations - Superannuation Industry (Supervision) Regulation 6.17A(6) and (7)

This SIS Regulation requires that a member of a superannuation fund who has provided the fund with a binding death benefit nomination renew that nomination every three years. This is incongruent with the requirements around wills, which only need to be reviewed upon a change in circumstances, and is unexpected for the member, who expects to only have to review the nomination on a change in circumstances.

A leading fund manager's costs around administering this requirement are:

- $30 000 per annum in printing and postage costs
- $200 000 (approx) per annum in processing the renewals

Recommendation 1: Either make the nomination without expiry, or extend the life of the nomination to a period more in keeping with the nature of the nomination, for example, 10 years would be a reasonable time in which to review these nominations.

2. Transfer of Units - NSW Duties Act 1997

In an unlisted unit trust, a transfer of units from one entity to another is required to be assessed for NSW Stamp Duty. This is required even in circumstances where there is no change in beneficial ownership of the units, for example a change in trustees, or a transfer from a parent holding units for the benefit of a child to the child's name once majority is reached, or transfer of secured units from a lender to the beneficiary upon completion of a margin lending arrangement. Thus, no stamp duty is payable, but the transfer must be assessed, and an administration fee paid for the assessment. This is time-consuming and costly to the investor, for no benefit to them.

A leading fund manager's statistics are as follows:

- approximately 4 000 transfer requests are received every year;

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- of these, approximately 60% have no change in beneficial ownership;
- therefore, approximately 2 400 transfers are assessed by the NSW Office of State Revenue and result in no duty paid, but an administration fee for them to handle the request.

This is inefficient and results in unnecessary costs to the fund, the investor and the NSW Office of State Revenue.

Recommendation 2: Transfers of units that involve no change in beneficial ownership be exempt from the stamp duty assessment process.

3. Margin Lending Requirements - Consumer Credit Protection

New rules for margin lending products will soon require the product provider to conduct a "suitability test" to establish that the product is suitable for the investor. However, the financial planner or adviser will have been through an assessment process for establishing the investment and loan. Financial advisers are required under the *Corporations Act 2001* to complete a full financial assessment under the "know your client" rules, and establish suitability for any products recommended. The adviser has a commercial relationship with the investor, and is in a significantly better position to make such an assessment. Therefore, a requirement for the product provider to undertake a second assessment process is inefficient and costly, with no benefit.

Recommendation 3: An investor must have an adviser and a completed Statement of Advice to apply for a margin lending product.

4. NSW Unclaimed Money Act 1995, Section 10, Corporations Act 2001, Section 601NG, Superannuation (Unclaimed Money and Lost Members) Act 1999, Sections 11-17

Most of the large wealth management institutions now manage both superannuation and non-superannuation investments. This raises issues when dealing with unclaimed monies. The unclaimed monies process is different for each investment type, and has a third process when dealing with terminated funds.

The management of unclaimed monies in superannuation is codified in the *Superannuation (Unclaimed Money and Lost Members) Act 1999,* and regulated by the Australian Tax Office (ATO). Unclaimed monies for non-superannuation products are dealt with in the *NSW Unclaimed Money Act 1995,* and regulated by the NSW Office of State Revenue. However, is dealing with terminated funds, the relevant act is the *Corporations Act 2001*, and regulated by the Australian Securities and Investments Commission (ASIC).

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This inconsistency of treatment and regulation leads to confusion and inefficiencies in the processes managing unclaimed monies in the wealth management sector.

Recommendation 4: A streamlining of the processes dealing with unclaimed monies to promote greater efficiency.

5. Superannuation Tax Deductions - Income Tax Assessment Act 1997, Sections 290-170, 290-180

A member of a superannuation fund must advise the fund of their intent to claim, amend or cancel a personal tax deduction on a personal superannuation contribution on an approved "Notice of intent to claim a tax deduction" form. However, due to advances in electronic payments and acceptance processes, many funds accept contributions by electronic means, for example direct credit, or BPay. The requirement to only accept the notice on the approved form means that superannuation fund members make the contribution electronically, then must forward a paper form to the fund to advise of their intent to claim a tax deduction for the contribution.

Recommendation 5: This requirement needs to be amended such that a superannuation fund member can advise the find of their intention to claim a tax deduction by other means deemed acceptable by the trustee, for example, electronically or by phone.

6. Departing Australia Superannuation Payments - Superannuation Industry (Supervision) Regulation 6.01B, 6.18

Under the Regulations, a temporary resident of Australia, who has departed the country, and had their visa cancelled may cash their superannuation benefits within six months of leaving Australia. The process becomes inefficient due to the fact that the superannuation fund can only release the benefits after receiving the request and notification from the member once they have departed Australia. This often proves difficult for the member due to not having contact details readily available from another country, and the cost and time associated with communicating with the fund from overseas.

Recommendation 6: A process be considered where the member can request the benefit payment upon departing Australia, possibly on a form at the point of departure, providing payment details, which is sent to the superannuation fund. This then awaits confirmation from the Department of Immigration and Citizenship of the cancellation of the visa.

7. Various State Acts administering Powers of Attorney

There is no consistency in the various state Acts administering Powers of Attorney, certification and witnessing. As an industry that is national, this means that the different State Acts and Regulations have to be referred to to ensure compliance with the laws around these items. There is no consistency, for example, in the format of a Power of Attorney document, whether the Attorney is entitled to benefits from the estate and who can witness the disclosures.

> **Recommendation 7**: Consistency in this area is needed to limit errors that may arise from the lack of consistency.

8. Superannuation Splitting - Family Law Act 1975 Part VIIIB

The Family Law Act allows for the splitting of superannuation interests in the event of marriage breakdown. These instructions come from superannuation fund members in the form of superannuation agreements in financial agreements or orders made on the dissolution of marriage. The administration of these instructions is made complicated by the fact that there is no consistency in the format of the instructions to the superannuation trustee; the superannuation component is simply one of the items in the financial agreement or orders. This can lead to inefficiencies in the process as a result of locating the relevant sections in sometime lengthy documents and interpretation of the sections, as there is no required wording.

> **Recommendation 8**: This process would be significantly improved if there were a required or approved form in which these instructions must be provided to superannuation trustees.

9. Superannuation Industry (Supervision) Act (SIS) – Illiquid Investments

The Global Financial Crisis clearly demonstrated difficulties with the management of redemptions and investment switches where an underlying investment is illiquid. While the Corporations Act as it applies to managed investment schemes contains provisions specifically dealing with liquidity, SIS does not. SIS does not contain any general ability of a trustee to "freeze" redemptions in circumstances where the relevant fund becomes illiquid in a corresponding fashion to section 601KA of the Corporations Act 2001. The rationale of this last type of provision is that it would be inequitable to investors generally to allow some investors to withdraw from the scheme in circumstances where inequity could ensue to other investors.

Where a regulated fund invests in an investment option which is or becomes illiquid, regulation 6.34 requires the transfer of a member's benefit within 30 days unless the member has consented to a longer period or APRA suspends the trustee's redemption

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obligation. The trustee of a regulated superannuation fund has only limited ability to defer redemption objections under SIS. This means that it must otherwise continue to process redemptions even though this process would deplete other assets of the fund including assets of other members. This will clearly generally not be in the best interests of the members as a whole and contrary to section 52 (2)(c) of the SIS Act.

In these circumstances, trustees must either have obtained the consent of the relevant members which will be impracticable or apply on an individual basis to APRA for relief. Section 155 may apply to some situations where the trustee either cannot work out the underlying investment price or that price would be unfair but it will clearly not have universal application. It follows from the above that, in the absence of regulatory intervention, regulation 6.34 places the trustee in a position for which there is no clear cut solution to overcoming this impasse and legislative uncertainty between:

1. the obligations(and gaps) in regulation 6.34 and section 155; and

2. the redemption obligations under SIS and the overriding duty to protect the interests of the whole investor base.

Recommendation 9: IFSA recommends that SIS regulation 6.41 be reviewed and that the provision be aligned with the operation of section 601KA of the Corporations Act 2001

10. Superannuation Confirmation Letters - Corporations Act 2001, Section 1017F and Corporations Regulations Division 5

The Corporations Act and Regulations require a confirmation letter to be sent by a superannuation fund for all transactions, except where the frequency and amount (or method of calculation) is agreed at the time of establishing the account or payment arrangement. Under this exception, employer-sponsored funds are exempt from sending confirmation letters for regular superannuation guarantee or other regular employer contributions. However, in a public offer fund, this exemption does not apply. This results in member's receiving confirmation letters for regular contributions that they are expecting as a matter of course, and that are required to be confirmed by the employer in their pay advice. CFS regularly receive complaints from members about the money and resources we are wasting on this requirement.

Recommendation 10: IFSA recommends that a superannuation fund member be able to request that they receive no transaction confirmation letters. These members are able to access information on their account at any time by contacting the fund, receive confirmation of the contributions in their pay advices, and receive semi-annual statements that list all transactions on their account. We believe that this is sufficient disclosure for many, if not all, superannuation find members.

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Insurance

11. State Taxes on Insurance

In all States and Territories, any person carrying on the business of general and/or life insurance is subject to insurance duty, otherwise known as stamp duties on insurance.[1]

On 15 January 2010 the Australian Government released the Australian Financial Centre Forum's report on Australia as a Financial Centre (the Johnson report). In response to the Government's commitment to position Australia as a leading financial services centre in the region, a Panel of Experts (consisting of six senior financial sector representatives, a Treasury Taskforce and a Reference Group) was convened to examine policy settings affecting the competitiveness of the industry.

The Report makes 19 recommendations. Recommendation 3.7 is to "remove state taxes and levies on insurance".[2] IFSA strongly support the recommendation.

Recommendation 11: IFSA supports recommendation 3.7 of the Johnson report which recommends that all state taxes and levies on the insurance sector be removed. [3] This should be addressed swiftly via the Henry Review and a timely response by Government.

12. Legacy Products

IFSA refers to our public submission on the Government's Product Rationalisation Proposals Paper.[4] The on-going operation of legacy products is a great burden to both industry and consumers, as is the need to address legacy products separately with each regulatory change that is made to the sector, due to the outdated nature of the products and the systems that support them.

Comprehensive IFSA recommendations to Government were first made in 2005. Based on an IFSA survey of 6 large financial services entities, funds under management in legacy products have grown from $68.6 billion to $92.4 billion in less than 5 years.

Recommendation 12: IFSA re-iterates support of the Government's action to address this growing problem. This long-awaited initiative is a win for Government, industry, and most importantly consumers. We recommend change is swift so that the removal of costly and inefficient products can occur as soon as possible.

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[1] ICA, *Submission to the Review of Australia's Future Tax System p.6*, October 2008
[2] Australian Financial Centre Forum, *Australia as a Financial Centre – Building on our Strengths p.73*, November 2009
[3] Australian Financial Centre Forum, *Australia as a Financial Centre – Building on our Strengths p.73*, November 2009
[4] Corporations and Financial Services Division, The Treasury, *Product Rationalisation of Managed Investment Schemes and Life Insurance Products*, 14 December 2009

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13. Insurance Contract Act Amendment Bill

Since 2007, IFSA have been involved in consultation on the Insurance Contracts Act Amendment Bill. IFSA welcomed further consultation on the Bill last year, but we are disappointed that the passage through Parliament has been delayed once again.

Of particular importance are the proposed amendments which relate to electronic disclosure. ASIC has recently undergone consultation on facilitating online financial services disclosure, but until amendments are made to the Insurance Contracts Act, the insurance industry will be unable to utilise the benefits of providing financial services disclosures online.

Recommendation 13: IFSA would welcome the quick progression of the amendments to the Act.

Macro/Consultation Issues

The following provides detail on specific consultations and the negative operational impacts experienced by industry as a result of particular consultations by Government and regulators. By reviewing these in detail and making the appropriate changes to the consultation and engagement framework and by making all parties more accountable, we can ensure the significant regulatory burden or cost associated with such is alleviated.

14. Long-Term Superannuation Reporting

The Corporations Amendment Regulations (No. 3) 2009 were registered 30 March 2009 and took effect from 1 July 2009. They required superannuation funds to disclose five and, eventually, ten year returns in periodic statements (including exit statements).

On 19 February 2010 Minister Bowen announced a number of refinements to the regulations. These refinements are to include:

- Exclusion of exit statements;
- Allow the industry to use inserts to provide five-year performance information for one more year up until 30 June 2011;
- Exempt “traditional” funds (of an insurance nature)

Whilst the refinements were welcomed by industry and in line with industry’s long-standing position on the matter, there remain concerns with regards to the timeliness of the announcement and consultation on the issue both prior and subsequent to regulation in mid-2009.

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Practical and operational impacts

As foreshadowed in the IFSA submission to Minister Bowen dated 19 June 2009, industry recognised numerous operational impediments to implementation of the regulation. The limited consultation period did not allow time for a proper evaluation of the practical impact and operational impact of the regulations.

Relief was not granted by ASIC on the basis that the regulations had just been made, the outcomes were intended by Government, and hence industry moved towards implementation. Many trustees undertook significant projects incorporating significant planning, I.T and resource spend.

There was no formal consultation from Treasury or ASIC subsequent to IFSA's submission, and no prior indication was given regarding the changes announced by the Minister. Hence implementation by industry had reached a point whereby the refinements, though welcome, were not as beneficial as they should have been simply via improved communication.

By the time of the Minister's announcement many trustees were at the point where:

- De-scoping of exit statements from projects will incur further significant costs and could lead to a situation where the industry is inconsistent in its disclosures (some trustees may deem it better to proceed with exit statements in scope). The wasted resource and expense of incorporating exit statements to this point is a poor outcome that should have been avoided.
- Many trustees will not be able to utilise the relief to utilise inserts until 30 June 2011, as they were nearing implementation. This effectively disadvantages efficient trustees who were seeking to compliant with the existing regulation and creates a situation of regulatory arbitrage.
- The exemption of traditional funds from certain requirements was raised with ASIC in late 2009 by certain trustees and no relief was provided. The inconsistency of ASIC's response with the final position taken by Government is of concern and highlight's the need for improved consultation between Government and the regulator so as not to disadvantage industry (and in turn consumers) by placing undue pressure and cost upon industry.
- Finally, it should be noted that there is no clear timeframe for regulation on this matter subsequent to the Minister's announcement. Industry must, once again, seek relief from ASIC as the significant work around implementation is now effectively put on hold before clear and final regulations are received from Government.

IFSA supports recommendation 4.1 of the Johnson report which recommends that any significant regulatory proposals applying to the financial services sector be fully tested and evaluated, in particular and where possible by way of detailed industry consultation, to ensure that they are necessary, effective and impose as small a compliance burden on industry as possible.[5] This supports the avoidance of unnecessary regulation whilst

[5] Australian Financial Centre Forum, *Australia as a Financial Centre – Building on our Strengths p.82*, November 2009

also ensuring the practical and operational impacts of new regulations are fully considered prior to implementation.

15. Short Selling

The Corporations Amendment Regulations (No.8) were amended on 25 November 2009 via Select Legislative Instrument 2009 no.327. The regulations prescribed separate commencement dates for transactional reporting and positional reporting of short sales.

A number of concerns raised with regards to the draft regulations via an IFSA submission to Treasury dated 27 October 2009 were not addressed. These included:

- Postponement of the implementation date for positional reporting to 1 July 2010;
- Applications of the requirements to offshore investors;
- Confidentiality of Transactional Reporting

The explanatory statement notes that the regulations were subject to ‘extensive consultations’. Certainly, the initial consultation was strong and led to regulations that met policy objectives supported by industry. However, crucial technical aspects raised by industry regarding the final draft regulations were neither addressed nor responded to. The rush to implement and lack of response late in the piece was not in line with the excellent prior consultation.

In particular industry had stressed that the implementation date for positional reporting should be shifted to 1 July 2010 in light of the compliance costs resulting from IT system builds, personnel training and reporting.

Additionally, while the initial justification for the introduction of the regime was in part international consistency, particularly with the US and UK, that consistency has not been achieved or maintained. On 25 February 2010 the SEC announced a rule restricting short selling when a stock experiences ‘significant downward price pressure’. The SEC’s rule is a price test and, intriguingly, represents a different approach to the Australian short selling rules where regular reporting is the focus.

Practical and operational impacts

As at 26 February 2010, industry is in the process of implementing the positional reporting requirements by 1 April 2010. In order to do this industry requires:

- ASIC to consult on the reporting threshold. As at 1 March 2010, *just 4 weeks from implementation*, such consultation has not been forthcoming. The reporting threshold is of extreme importance for industry as it will dictate the volume of transactions reported and potentially impact the system build.

- ASIC to update RG 196 to incorporate guidance on the new regulations. As at 1 March 2010, this update has not been forthcoming. Industry is essentially implementing “in the dark” without renewed guidance. It is yet to be seen if significant concerns regarding confidentiality of transactional reporting are addressed in the guidance. A number of interpretative and definitional

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questions also need to be addressed e.g. what is the operational meaning of "seller" within the regulations.

- ASIC to provide a final version of their "FIX Rules of Engagement" document. As at 1 March 2010, this document is still in draft format. Industry is proceeding with system builds on the basis of the draft document.

As at 1 March 2010, industry is preparing an approach to ASIC on above issues. Government apparently was "committed" to this timeframe regardless of the significant implementation hurdles and operational risks generated.

The lack of guidance has led to commercial uncertainty, increasing business costs, and inefficiencies in implementation (the full impacts of which are yet to be determined at the time of writing). Government, regulators and industry need to work closely to ensure they are aware of each other's capabilities and limitations to achieve efficient and timely regulatory change implementation.

The legislative and regulatory actions in relation to long term superannuation reporting and short selling are examples of the need for the introduction of a standardised formal consultative process. In the absence of such a process industry will repeatedly be subjected to legislative/regulatory changes that result in unintended consequences and costs.

Recommendation 14: IFSA recommends that:

1. recommendation 4.1 of the Johnson Report be adopted which recommends where regulation requires significant implementation in a short period of time yet may be subject to review or change, regulatory taskforce oversight should be mandatory. This would allow for greater collaboration between Government, regulators and industry leading to a reduction in unnecessary costs and improved regulatory outcomes, particularly with regards to efficient implementation and compliance by industry.

2. a taskforce be established not dissimilar to the Financial Sector Taskforce proposed by recommendation 6.3 of the Johnson report, with a similar focus of consulting widely with the financial sector, so as to act as a conduit between the sector, the Government and its advisers (including regulators).[6] This taskforce would focus on significant industry developments outside the scope of the Johnson taskforce and ensure the objective of an on-going partnership between Government and the industry[7] is embraced more widely.

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[6] Australian Financial Centre Forum, *Australia as a Financial Centre – Building on our Strengths p.115*, November 2009

[7] Australian Financial Centre Forum, *Australia as a Financial Centre – Building on our Strengths p.114*, November 2009