SECURITIES & DERIVATIVES INDUSTRY ASSOCIATION

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10 November 2005

Mr Maurice L Newman AC
Chairman
Financial Sector Advisory Council
C/- Financial System Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

By email: fsacsecretariat@treasury.gov.au

Dear Mr Newman,

Financial Sector Advisory Council: enquiry into financial sector regulation

Thank-you for your letter of 23 September 2005 inviting comments on practical improvements to the operation of financial sector regulation.

The Securities & Derivatives Industry Association on behalf of its members would like to make the comments outlined in the following pages, which address the seven questions in your letter.

Should the Council require any further information, please contact me on 02 9776 7911 or email: dhorsfield@sdia.org.au, or Doug Clark, Policy Executive, on 0417 168804 or email: dclark@sdia.org.au.

Yours sincerely,

David Horsfield
Managing Director

ABOUT SDIA: The Securities & Derivatives Industry Association is the peak body representing the interests of market participants in Australia. SDIA was formed in 1999 at the time of the demutualisation of the Australian Stock Exchange. Currently we have 65 member organisations which account for some $3b worth of trading daily on the ASX which is approximately 98% of the market. In addition we have over 1300 individual members and are working to build the profession of stockbroking. Our member firms employ in excess of 8,000 people.

SECURITIES & DERIVATIVES INDUSTRY ASSOCIATION

RESPONSE TO FINANCIAL SECTOR ADVISORY COUNCIL
Enquiry into Financial Sector Regulation

With the full implementation of the Financial Services Reform legislation having occurred nearly 2 years ago, our Members are pleased to contribute to the Council's current enquiry into the operation of financial services industry regulation.

The intention of the Wallis Report (Financial System Inquiry Final Report, 1997) and of the legislative changes that it prompted, was to:

- *create a flexible regulatory structure which will be more responsive to the forces for change operating on the financial system;*
- *clarify regulatory goals;*
- *increase the accountability of the agencies charged with meeting those goals;*
- *ensure that regulation of similar financial products is more consistent and promotes competition by improving comparability;*
- *introduce greater competitive neutrality across the financial system;*
- *establish more contestable, efficient, and fair financial markets resulting in reduced costs to consumers;*
- *provide more effective regulation for financial conglomerates which will also facilitate competition and efficiency; and*
- *facilitate the international competitiveness of the Australian financial system.*

These goals were also included in the Explanatory Memorandum to the Financial Services Reform Bill, 2001. FSR was intended to simplify regulation, to create a flexible structure and clarify regulatory goals.

When discussing the regulatory regime surrounding conduct and disclosure in Australia, the Wallis Report made the point that

> *Disclosure regulation is at the core of any scheme to protect consumers as it allows them to exercise informed choice. However, it is the quality and usefulness of information which are important, not its quantity. Excessive or complex information can be counterproductive as it may confuse consumers and discourage them from using disclosure documents. Complex disclosure requirements also increase industry's compliance costs which are ultimately borne by consumers.*
>
> *The aim of regulation should be effective disclosure, not merely the production of information.*

Unfortunately, in the period since the Act was passed these goals and intentions have been overtaken by increasing levels of complexity and detail, to the point that the regime surrounding advice and disclosure has become a complex web of legislation, regulation, ASIC policy statements, class orders and FAQ clarifications.

Whilst outside the scope of the Council's current enquiry, our Members welcome the Government's *FSR Refinements* project, which will provide clarification and simplification in some key areas that have become increasingly difficult to administer (and confusing for advisers and their clients). However, the *Refinements*, whilst helpful, do not meet the need for

a wide-ranging review of the regulatory regime surrounding the Financial Services industry in Australia.
SDIA is therefore pleased to provide comments to this timely enquiry by the Council. We wish to address each of the seven matters in turn:

1. What particular aspects of the existing financial sector regulation present the greatest challenges for your industry grouping or business (please note where challenges are transitional)? What impact does this have on the efficiency of your business and the financial sector as a whole?

1.1 The Dollar Disclosure regime[1]

The Dollar Disclosure regulations were introduced in 2004 with their commencement scheduled for 1 July 2004. ASIC granted interim Class Order relief from the obligations by extending the implementation date to 1 July 2005.

As foreshadowed in several submissions to the Parliamentary Joint Committee reviewing the Dollar Disclosure regulations[2], many financial service providers - including our Members - have encountered difficulties with implementing the regime. The systemic changes are complex and costly, requiring significant lead times to execute. To that end, in June 2005, SDIA requested further interim relief from ASIC in respect of the Dollar Disclosure obligations for Statements of Advice (SoAs):

> *While we understand ASIC's policy imperative in implementing the Regulations, we would also submit that for the bulk of our Members, compliance is not possible within the time frame – or at the very least, it is unreasonably burdensome within the time frame. We seek an extension of the time frame in which to implement the requirements.*
> *…*
> *We know that for Members* [after the *FSR Refinements* become effective] *there will be a significant diminution in the number of SoAs that will be given to clients – if the proposals are adopted in any form similar to what has been tabled for consultation. Such a diminution in SoA numbers will have a bearing on what kind of solution many of the Members would prefer to adopt – particularly among those larger firms (who run 'new' stand alone systems developed in-house or 'new' SoA functionality built in to legacy system). The fact that the SoA regime is in transition pending the conclusion of consultation on the refinements and then final implementation is itself a good reason to further delay the dollar disclosure requirements.*[3]

(While the above correspondence with ASIC referred to SoAs, we note that the Dollar Disclosure regime also applies to Personal Advice in all circumstances, including advice by telephone.)

In the event, ASIC did not grant any further relief. Nonetheless, we continue to assert that the obligations are unreasonably burdensome. We would also submit that the Dollar Disclosure regulations – and the narrow way in which they are being read in the wider context of the FSR Act – are not an effective means of achieving the desired policy objectives.

Meaningful disclosure

One of the overarching principles of the Financial Services Reform Act continues to be the protection of retail investors. Underpinning these protection measures is the requirement for service providers, when giving advice, to disclose any interests "that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice."[4]

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[1] This issue falls outside the *FSR Refinements* project
[2] Parliamentary Joint Committee on Corporations and Financial Services, March 2004, *Report on Corporations Amendment Regulations* Batches 6, 7 and 8.
[3] Submission from SDIA to ASIC 17 June 2005
[4] *Corporations Act* section 947B

SDIA Members recognise the disclosure regime as a tenet of investor protection. We also acknowledge the views of the Australian Consumers' Association (ACA) who have stated that:

> …consumers must be provided with information to make the informed choices as to financial services and products envisioned in the objectives of the Financial Services Reform Act 2001.[5]

In addition, we also endorse the views of the ACA in relation to 'meaningful disclosure':

> In devising a 'meaningful' disclosure format, we must be mindful of the low levels of financial literacy among the Australian population. 'Meaningful' must be from the consumer's perspective, not what is convenient for product developers. [6]

Manifestly, disclosure of interests *should* be 'meaningful'. It would be mischievous to devise and deploy 'meaningless' disclosure. However, "not what is convenient for product developers" suggests that any mandated disclosure regime need not take into account the cost, complexity, feasibility or suitability of making the disclosures. Such lack of consideration runs contrary to the counterbalancing aims of the Act; namely, to promote both:

> …confident and informed decision making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services[7]

We would submit that Dollar Disclosure is only one way of meeting the FSRA objectives. We do not believe it is efficient, nor can we say that it is in any way flexible. The SDIA wishes to propose a variation to the Dollar Disclosure regime for Statements of Advice which would fulfil both sets of objectives of the Act, and do so in a manner which is achievable and affordable for service providers.

Meaningful disclosure – standardised examples

The SDIA believes that standardised, 'plain English' examples for various asset classes (and services) will provide meaningful disclosure to investors. As an illustration, following is a standardised example for a share trade on the Australian Stock Exchange:

Trading Shares On The ASX If you bought $10,000 worth of shares, the *maximum* you would pay at our standard rate is…		
The total you will pay (includes GST)	What ABCBroking will receive	What ABCBroking will pay your adviser for this trade (in addition to their salary)
$10,222	**$222**	**$90**
For complete details of our fees and charges, please refer to the attached schedule.		

It is proposed that Members of the SDIA would subscribe to a charter of standardised examples, published by the SDIA, which would:

[5] Australian Consumers' Association submission to the Parliamentary Joint Committee on Corporations and Financial Services, re Batch 8 Regulations; not dated.
[6] Australian Consumers' Association submission to the Parliamentary Joint Committee on Corporations and Financial Services, re Batch 8 Regulations; not dated.
[7] *Corporations Act* section 760A

- define the terminology used for all fees, charges, commissions &c;
- prescribe example amounts for each asset type and service (where applicable);
- specify the wording and format[8] of each example; and
- stipulate that amounts are the maximum amounts charged by the service provider (or product issuer).

We believe this approach has several merits:

- ***Exceeds current regulatory requirements***
  In some instances, the proposed 'standardised examples' method exceeds what the Regulations prescribe. For example, it is not possible to calculate the amount an adviser will receive in commission if that amount depends on a future event (such as reaching a certain volume threshold over time). In those instances, the service provider is not compelled to disclose a dollar amount but may instead provide a percentage and worked dollar example. Although the standardised example does not yield the *actual* amount of a commission, it still provides exactly what the consumer requires – an unambiguous dollar figure for a 'real-life' example.
- ***Clear, concise and effective***
  The SDIA would submit that the standardised example is more "clear, concise and effective" [9] than providing worked dollar examples.
- ***'At a glance' comparability***
  The ACA have stated that:
  Another crucial element in disclosure of fees and charges is comparability. Not only must consumers be able to understand how much different products cost, they must also be able to compare those costs, and 'shop around'… [10]
  The SDIA submits that because the standardised example provides a single 'drive away' figure, with clearly itemised details of all fees, charges and commissions, it effectively allows investors (with varying degrees of financial literacy and arithmetic skills) to compare service providers and products within the same industry sector.
- ***Promotes competition***
  We believe that the clarity and comparability of the 'drive away' figure may promote competition between service providers – especially given that the charter will stipulate that any amounts quoted must be maximum amounts charged.
- ***Affordable and achievable***
  When the FSR Act was introduced, actual dollar disclosure in Statements of Advice (SoA) was not prescribed. As such, the design and construction of SoA systems and procedures did not include the facility. To retrospectively introduce the facility will require prohibitive cost where it is feasible to automate the process. Where it must become manual, the administrative cost and inefficiency will be even greater. The standardised example is affordable, feasible, practical and reasonable. It does not threaten to increase costs for investors.

In summary
The SDIA would like to emphasis that it emphatically endorses the objectives of the FSRA disclosure regime. Engendering investor confidence is beneficial for all participants of the investment community. Nonetheless, we also endorse the views expressed by the Chairman of the Productivity Commission:

> *Regulations are sometimes unduly prescriptive, setting down subsidiary rather than fundamental objectives as requirements, with the result that while the subsidiary requirement is met, the underlying purpose of the regulation may not.* [11]

[8] …though not style.
[9] Section 947B(6) of the Corporations Act.
[10] Australian Consumers' Association submission to the Parliamentary Joint Committee on Corporations and Financial Services, re Batch 8 Regulations; not dated.

We believe the Dollar Disclosure regime is unduly prescriptive. It mandates subsidiary obligations, based on a kind of 'regulatory fundamentalism', which undermine the tenets of investor protection. We believe our proposal provides a simpler, affordable and effective alternative, and we commend it to you for your consideration.

2. What proportion of your firm's administrative processes and resources are devoted to compliance activities that it would not undertake if the regulation did not exist? Please distinguish from procedures and activities (e.g. accurate record keeping) that would likely occur without regulatory stipulation.

The answer is, an increased proportion than prior to FSR. A survey of our Members in 2005 showed that Compliance Costs in most firms had risen **3-6 times** in the last 3 years.

Last year we provided the Council with the following example, which remains valid. These are typical costs for a large retail stockbroking operation:

Initial (once off FSR project costs)

Savings

None

Costs

Business unit participation in applications	$750k
Legal advice/assistance with relief applications	$500k
FSGs	$400k
SoA system	$1000k
Training – initial legislation	$100k
Other system changes	$100k
Stationary changes	$100k
Total	***$2.95m***

Ongoing (recurring – per annum)

Savings

None

Costs

Additional FSR specific on-going training	$50k
Additional staff: 1 x FSRA co-ordinator	$120k
Additional staff: ½ x legal counsel	$80k
SoA system support and enhancements	$100k
Labour on SoA production	$1m
Paperwork (SoAs, FSGs &c production + mailing)	$250k
Total	***$1.6m***

3. Have you identified any of the following features which may impact on the efficiency of financial sector regulation?

(a) Overlaps between regulatory requirements, both in terms of meeting legal and administrative requirements (e.g. between two or more of the following: APRA, ASIC, ACCC, RBA, ASX, ABS etc…).

[11] Gary Banks, Chairman of the Productivity Commission *The good, the bad and the ugly: economic perspectives on regulations in Australia* Address to the Conference of Economists 2003, Business Symposium, Canberra. 2 October 2003

3.1 ASX and ASIC

Our Member firms are both Market Participants under ASX Market Rules and financial service licensees under the *Corporations Act*.[12] As such they are regulated by ASX and ASIC. This has been the position for many years, but the on-going effect of duplication of rules and enforcement has become critical in recent years, especially with the advent of FSR, to the point where it threatens the efficiency of financial sector regulation.

Under the *Corporations Act* section 792A and its Market Operator's licence, ASX must:

*(a) to the extent that it is reasonably practicable to do so, do all things necessary to ensure that the market is a **fair, orderly and transparent market**; and*

(b) comply with the conditions on the licence; and

(c) have adequate arrangements (whether they involve a self-regulatory structure or the appointment of an independent person or related entity) for supervising the market, including arrangements for:
(i) handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the market operates in the way mentioned in paragraph (a); and
*(ii) **monitoring the conduct of participants** on or in relation to the **market**; and*
*(iii) **enforcing compliance** with the market's operating rules; and*

*(d) have sufficient resources (including financial, technological and human resources) to **operate the market properly** and for the required supervisory arrangements to be provided…*
(emphasis added)

The problem lies particularly with rules concerning **client relations**, particularly in ASX Market Rules Chapter 7.

The following Table gives several examples of areas which are subject to duplication and/or overlap of requirements administered by ASX and ASIC:

Subject	**Corporations Act**	**ASX Market Rule**
Client Order Priority	s991B	7.5
Confirmations	s1017F	7.9
Managed Discretionary Accounts	ASIC CO04/194; PS179	7.10
Principal Trading	s991E; Regs 7.8.20, 7.9.63B(4)	7.3
Staff Trading	s991F	7.8.2
Trading Records	s988E; Reg 7.8.11	4.10
Trust Accounts	s981C; Reg 7.8.01&02	7.11

There is no requirement that client relations be covered in ASX Rules: s792A concentrates on supervising **the market**, ensuring a fair and orderly **market** and monitoring the conduct of participants on or in relation to **the market**. There is no mention of regulating matters of relations with clients.[13] Other licensed markets[14] have chosen to recognise this duplication, and incorporate more *Corporations Act* requirements in their rules by reference without repeating them. It would simplify the regulation of this sector if ASX were to adopt a similar attitude, especially in relation to client relations matters.

Complying with 2 sets of requirements means that staff must be familiar with both the law and the rules. Firms must have compliance programmes which address both sets of requirements. This reduces efficiency and increases costs, and is very difficult to justify, particularly where the requirements are very similar. If they were the same, at least our Members would only need to look at one set of requirements (albeit duplicated). However this is not the case, with

[12] Some are also Participants of the Sydney Futures Exchange
[13] Note for example the absence from the *duplications table* of **Short Selling**, which is covered by the Act (s1020B) and the ASX Market Rules (Chapter 19) and properly so, since short selling has a potential effect on **the market** through volatility, etc.
[14] e.g. Bendigo Stock Exchange and the Stock Exchange of Newcastle

most of the above examples having differences between the Act and the Rules which need to be taken into account.

Confirmations: in this regard we note that after a series of submissions by SDIA, ASX this year amended its rule on reporting transactions to clients. The changes align the ASX rule more closely to the Corporations Act which, post-FSR, no longer requires confirmations to be given to wholesale clients, only retail. The ASX rule now excludes some, but not all wholesale clients – the important exception being intermediaries – from the obligation to be given a confirmation.

Enforcement: As well as the subject matter of the rules, there is also on occasion duplication of the enforcement of the rules. This is perhaps inevitable where the jurisdiction of ASX and ASIC is blurred by overlapping or identical requirements. In the pasts there have been agreements as to ASX's role as 'lead regulator' of market participants. This gave some clarity, but is no longer the case. The current MOU between ASX and ASIC signed in 2004 covers matters such as: management of [ASX] conflicts, communications and breach reporting between the 2 bodies. Moreover, there has been unfortunate overlaps in the timing of monitoring activities. At the end of 2004 and early this year, ASIC embarked on a much-publicised 'stockbrokers campaign' involving target surveillance of a number of our Members. At the same time, ASX was also conducting its annual review of brokers. While approaches by SDIA led to more time being given, it was disappointing that greater co-ordination in the planning phase of the campaign by ASIC had not taken place.

3.2 Breach Reporting

Another issue involving problems of regulatory duplication is breach reporting, where our Members must report significant breaches to the relevant regulators.[15] One Member noted that a matter arose which needed to be reported to ASX, ASIC and SFE. This makes no sense and is difficult to administer in practice, as the relevant criteria are not identical.

(b) Inconsistencies between regulatory requirements.

see comments at (a) above

(c) Regulation that is out-of-date due to industry trends.

The removal of broker numbers from ASX transactions as part of the ASX Equity Market Reforms at the end of November 2005 presents an ideal opportunity to rationalise and modernise various trading rules, including for example, the crossing rule.

(d) Regulation that is hindering the introduction of new products, working against industry developments or creating inappropriate barriers to entry.

Derivatives: in relation to new products problems have arisen from the need to have certain new derivative products (usually warrants) categorised as derivatives rather than miscellaneous products. This has meant some brokers have needed to amend their licence to continue to trade in miscellaneous products. In recent discussions with ASIC, we note that this is an issue being considered and which may soon be resolved by the Commission.

4. Can you suggest ways of improving the ongoing operation of particular aspects of the regulation in practice? What role can the regulator(s) play in this?

Drawing on our comments at 3(a) above, the key is to identify duplication and rationalise it.

[15] The associated issue of 'materiality' in breach reporting is a very significant on-going problem but will not be covered in this submission.

At the 2004 SDIA National Conference, ASX announced a regulatory scope review. Part of the review was to identify areas of possible duplication with other regulatory requirements. We welcome this initiative and look forward to its results, which we trust will address some or all of the matters we have raised above.

5. Have you received any complaints or positive feedback from your stakeholders that relate specifically to your compliance with the particular financial sector regulation (e.g. from clients, creditors, third party service providers, shareholders, etc)?

Paper Overload: Our Members have numerous clients complaining about the "paper overload" that the regulations are forcing on them. Faced with the barrage of new documentation (including Financial Services Guides, Product Disclosure Statements, Statements of Advice, new CHESS Agreements and/or compulsory ASX notifications), clients are often overwhelmed. Client profile documentation also adds to the volume of documents. This is an important document but clients often look at it and many consider it is just too much trouble to fill in - even when it is clearly in their interests to ensure advice is appropriate. Unfortunately these documents are often overlooked, and indeed, discarded. Added to this is the recognition that the paperwork means that it may be uneconomic to deal with a prospective client that does is not likely to produce enough revenue to overcome the administration costs.[16] This means that the "mums & dads" are NOT being serviced and are being channeled to non-advisory service providers, perhaps without the advice and protection they need. Consequently, the clients that most need the protection offered by the law are not getting it. The new *Refinements* should overcome the SoA aspect of this problem – since there should be fewer sent - but not much else.

6. What have been your experiences dealing with the regulators and Treasury on the particular financial sector regulation?

ASIC: Last year we commended ASIC for the way in which it managed the transition to FSR. This situation continues. We do not always agree with ASIC's views, but Policy proposals are always clearly outlined, and ASIC usually allows enough time for industry consultation. They respond in writing either through general communications to industry groups, or directly through publications such as press releases, answers to FAQs, class orders and policy statements (in both exposure draft and final versions). We are particularly grateful that ASIC makes its officers available for regular SDIA liaison meetings and also for workshops, conferences and events organised from time to time, and also that we are given the opportunity to comment on publications on a 'pre-release' basis, which generally improves the quality of the final product.

In relation to its relations with ASIC, one of our Members recently made the following observation:

> *We have no problem with Regulators for the most part, but are getting very tired of training every new analyst that ASIC employs about what the Finance industry is, what a market participant is, and what we do for a living. As soon as we get a contact that we can converse with, they leave to go to a broker or planner or bank or another regulator's office and we have to start all over again.*

Another stated:

> *Our dealings with ASIC have been very reasonable although the process has at times been much slower than we would have liked.*

[16] Unlike other industries (for example the airlines), our Members are not in a position to pass on the added compliance costs as 'taxes, fees or levies'.

Treasury: SDIA continues to have a good working relationship with Treasury. Perhaps because of its broader coverage of the finance sector than ASIC, specialised knowledge of our industry is not always as high, which is to be expected. Relations are enhanced by the relatively low turnover of Treasury staff. On occasion, often due to the demands of the Parliamentary timetable, insufficient time is allowed for the consideration of draft law or regulations to allow proper industry feedback.

7. Please provide any additional comments that you may wish to make relating to the particular financial sector regulation.

Foreign Company Reporting: An inefficiency that affects our Members which are foreign companies is the repetition in reporting to ASIC. Companies have to lodge the Foreign Company Annual Accounts (FS75), Statement to verify financial statements of a foreign company (form 405) and the Annual return of a foreign company (form 406). All of these gather similar information with varying degrees of detail and carry their respective lodgement fees. Our Members would like to see these rolled into a single lodgement capturing all the relevant details with one lodgement fee, thereby saving time and money for the business and simplifying some of the regulatory administration.